MINISTRY OF FINANCE

Economic Survey

Autumn 2020

Economic Prospects

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Economic Survey

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Abstract

Finland's gross domestic product is expected to contract by 4.5% in 2020. In addition to the exports, both private consumption and private investments will also decrease. Higher public spending will support economic growth this year. The GDP is expected to grow by 2.6% in 2021 and by 1.7% in 2022.

The economy will start picking up at the end of this year, but the recovery will be slow because of growing uncertainty and weak confidence among economic agents. Not all sectors of the economy will recover from the sudden halt experienced in the first half of the year at the same speed. Private consumption will fare best even though no rapid upturn in the demand for private services is in sight. Fall in housing construction is also slowing down the recovery of investments. Exports and industrial production have been hit by the continuation of the pandemic and growth in these sectors will only resume in 2021.

The employment rate will decrease by 2% this year and will start recovering during the second half of 2021. Unemployment will reach 8.2% next year. There will be a gradual recovery of the employment rate, but it will remain at 71.9% in 2024.

Finland's general government deficit will reach EUR 18 billion this year and general government debt will increase to about 70% of the GDP. In the next few years, the imbalance between general government revenue and expenditure will narrow as the economy picks up and the temporary support measures introduced by the Government come to an end. However, general government finances will remain substantially in deficit and the debt-to-GDP ratio will continue to grow.

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Tiivistelmä

Bruttokansantuotteen arvioidaan supistuvan 4,5 % v. 2020. Viennin lisäksi supistuvat yksityinen kulutus sekä yksityiset investoinnit. Julkisten menojen lisääntyminen tukee talouskasvua tänä vuonna. BKT:n arvioidaan kasvavan 2,6 % v. 2021 ja 1,7 % v. 2022.

Talouden toipuminen tämän vuoden loppupuolelta alkaen on hidasta taloudenpitäjien alhaisen luottamuksen sekä epävarmuuden kasvun seurauksena. Talous toipuu alkuvuoden pysähdyksestä asteittain. Nopeimmin palautuu yksityinen kulutus, mutta yksityisten palveluiden kulutuksen kasvu jää edelleen vaisuksi. Investointien toipumista heikentää myös asuinrakentamisen väheneminen. Vienti ja teollisuustuotanto kärsivät globaalin pandemian jatkumisesta ja kääntyvät kasvuun vasta ensi vuoden puolella.

Työllisyys supistuu 2 % v. 2020 ja alkaa palautua ensi vuoden loppupuolella. Työttömyysaste nousee 8,2 prosenttiin v. 2021. Työllisyysaste palautuu vähitellen, mutta jää 71,9 prosenttiin v. 2024.

Julkisen talouden alijäämä kasvaa tänä vuonna 18 mrd. euroon ja julkisyhteisöjen velka n. 70 prosenttiin suhteessa BKT:hen. Lähivuosina julkisen talouden tulojen ja menojen välinen epätasapaino pienenee, kun talous elpyy ja hallituksen päättämät covid-19-epidemiaan liittyvät väliaikaiset tukitoimet päättyvät. Julkinen talous pysyy kuitenkin tuntuvasti alijäämäisenä ja velkasuhde jatkaa kasvuaan.

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Sammanfattning

Bruttonationalprodukten väntas krympa med 4,5 procent år 2020. Utöver exporten minskar även den privata konsumtionen och de privata investeringarna. Ökningen av de offentliga utgifterna stöder den ekonomiska tillväxten det här året. BNP beräknas öka med 2,6 procent 2021 och med 1,7 procent 2022.

Den ekonomiska återhämtningen från och med slutet av detta år är långsam som en följd av det låga förtroendet för ekonomin och den växande osäkerheten. Ekonomin återhämtar sig stegvis från stagnationen i början av året. Den privata konsumtionen återställs snabbast, men ökningen i den privata konsumtionen av tjänster förblir svag. Minskningen i bostadsbyggandet hämmar också återhämtningen inom investeringar. Exporten och industriproduktionen lider av den fortsatta globala pandemin och börjar växa först nästa år.

Sysselsättningen minskar med 2 procent 2020 och börjar återhämta sig i slutet av nästa år. Arbetslöshetsgraden stiger till 8,2 procent 2021. Sysselsättningsgraden återgår småningom men stannar på 71,9 procent 2024.

Underskottet i de offentliga finanserna ökar i år till 18 miljarder euro och de offentliga samfundens skuld till ca 70 procent av BNP. Under de närmaste åren kommer obalansen mellan den offentliga ekonomins inkomster och utgifter att minska allteftersom ekonomin återhämtar sig och de temporära stödåtgärder som regeringen beslutat om upphör. Den offentliga ekonomin uppvisar dock ett avsevärt underskott och skuldkvoten fortsätter att öka.

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SYMBOLS AND CONVENTIONS USED

-	nil
0	less than half the final digit shown
..	not available
.	not pertinent
**	forecast
CPB	CPB Netherlands Bureau for Economic Policy Analysis
HWWI	Hamburgisches WeltWirtschafts Institut
IMF	International Monetary Fund
MEAE	Ministry of Economic Affairs and Employment
MoF	Ministry of Finance
MSAH	Ministry of Social Affairs and Health

Each of the figures presented in the tables has been rounded separately.

ECONOMIC SURVEY AUTUMN 2020

This Economic Survey offers projections of economic developments in 2020–2022. In addition to short-term prospects, it includes a medium-term economic outlook extending to 2024.

The forecast and trend projections in the survey are prepared independently by the Ministry of Finance Economics Department based on the Act on the implementation of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union and on multi-annual budgetary frameworks (869/2012).

The forecasts are based on national accounts data for 2019 published by Statistics Finland in August 2020 and on other public statistical sources available by 18 September 2020. The decisions made by the Government in its budget negotiation on 16 September 2020 are taken into account.

Helsinki September 2020

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Preface

The Finnish economy has contracted during three successive quarters. During the second quarter of 2020, the economic output was about 6.5% lower than in the third quarter of 2019. The sharp downturn is mainly due to the COVID-19 pandemic. It hit the Finnish economy hard in spring even though preliminary figures indicate that we suffered slightly less than other European countries. However, the Finnish economy was already in a downturn when the pandemic, the uncertainly arising from its spread and measures taken to contain it hit our exports, industrial output and investments, employment and household consumption.

According to the macroeconomic forecast produced by the Ministry of Finance, the economy started to grow during the summer and the growth is expected to average just about 2.5% in 2021. Private consumption will be the first sector to recover, followed by exports, which will be driven by a global economic upturn. However, private investments will only pick up when there is certainty of the economic outlook and the production capacity is again in full use. Public demand will give a substantial boost to growth this year, but its impact will also be felt in 2021. With the help of quantitative easing by central banks, extensive measures by national governments and, ultimately, the EU Recovery and Resilience Facility, the economic policy will be able to support growth in global scale.

The pandemic subsided during the summer months, which encouraged households in many countries (including Finland) to spend more. However, in recent weeks, the pandemic has been raising its head in Finland and in many other European countries. The economy is again at a crossroads.

Households and companies will remain cautious as long as the pandemic is progressing in waves and the measures to contain it are inadequate to eliminate the risk of infections. Moreover, the output and investments will only recover if there are new orders. The industry's order stock has declined at an alarming rate and if companies do not receive new orders, we may be in for a major economic backlash.

The pandemic is not yet over. The Ministry of Finance bases its forecast on the assumption that there will not be any second coronavirus outbreak in Finland or in the rest of the world. However, the risks are there, and the situation will remain unclear until an effective treatment and vaccines become available. Ultimately this will happen. After that, the economy may grow at a brisk rate for a while.

As a result of the pandemic and the general government measures to alleviate its negative impacts, Finland's general government deficit will widen, and its general government debt will increase by an additional EUR 20 billion this year. Borrowing could not have been avoided and preventing it would have been out of the question as a policy option. It is worrying, however, that Finland's general government finances will also remain substantially in deficit and we will accumulate additional debts after the pandemic is over.

According to a Ministry of Finance estimate, the imbalance in Finland's general government finances is a long-term problem and in 2024 (the base year of the calculations), the deficit will amount to about 3.5% of the GDP or almost EUR 10 billion). The imbalance is primarily due to the ageing of the population, which will boost the need for health and social services and public spending at a rapid rate every year until the early 2040s.

At the aftermath of the COVID-19 pandemic, Finland's general government finances are substantially more indebted and the long-term financing imbalance means that if no corrective action is taken, public debt will continue to grow and the rate of growth will accelerate in the coming years.

Halting the growth in the debt-to-GDP ratio is key to ensuring responsible management of general government finances and Prime Minister Marin's Government has decided on a programme that will help Finland to achieve this goal during the 2020s.

There are also other issues on the economic policy agenda as the Government is drawing up visions for the Finnish economy and society for the coming years and decades.

In addition to the responsible management of general government finances, the economic policy must also support the global economic and social transition, which is driven by demographic changes, climate change and new technologies. Measures that support the creation of economic value, and effectiveness and efficiency in public output are key issues on this agenda. These measures must support employment, learning, expertise, investments, productivity and competitiveness. Finland must build up its resources and use them more extensively and efficiently.

Economic and social transition is a global phenomenon and it will progress whether we want it or not. We can only benefit from the opportunities opened up by the transition by actively influencing its direction and speed. If we ignore the process, we may well be overwhelmed by the demographic change, climate change and the technological change, and the most vulnerable groups and regions will be hit particularly hard.

Summary

Economic outlook for 2020–2022

The contraction caused by the COVID-19 pandemic in the Finnish economy in the first half of the year was less severe than in most other European economies. We are dealing with a major disruption affecting private consumption and the demand for services, which has substantial impacts on employment and income. The economy will start picking up at the end of the year, but the recovery will be slow because of growing uncertainty and weak confidence among economic agents.

Finland's gross domestic product is expected to contract by 4.5% in 2020. In addition to the exports, private consumption and private investments will also decrease. Higher public spending will support economic growth this year.

Not all sectors of the economy will recover from the sudden halt experienced in the first half of the year at the same speed. Private consumption will recover more quickly than the other sectors even though no rapid upturn in the demand for private services is in sight. Fall in housing construction is also slowing down the recovery of investments. Exports and industrial production have been hit by the continuation of the pandemic and growth will only resume in 2021. The GDP is expected to grow by 2.6% in 2021 and by 1.7% in 2022.

Finland will experience a substantial weakening of its general government finances this year. General government deficit will reach EUR 18 billion and general government debt will increase to about 70% of the GDP. In the next few years, the imbalance between general government revenue and expenditure will narrow as the economy picks up and the temporary support measures introduced by the Government come to an end. However, general government finances will remain substantially in deficit and the debt-to-GDP ratio will continue to grow.

Countries will not recover at the same pace

The COVID-19 pandemic plunged the world economy into a deep downturn but there are many indicators suggesting a recovery in the third quarter of this year. The global economy will contract by 6.1% in 2020 and will grow by 5.5% next year.

There was a sharp contraction in the Chinese economy in the first quarter of this year when the pandemic was at its most difficult stage. However, tough measures to contain its spread proved successful and the economy has been on the mend since the second quarter. The GDP will contract by 2.3% this year and a growth rate of 8.5% is expected for 2021.

According to preliminary figures, the euro area economy contracted by almost 12% in the second quarter from the previous quarter. The service sector has been hit particularly hard by the restrictions imposed by national governments. The euro area GDP will contract by 9.6% this year and grow by 5% in 2021.

Even though the United States is still in the grip of a severe COVID-19 epidemic, the number of new cases has decreased. The economic recovery is, however, on a fragile basis due to an unstable social situation. The GDP of the United States will shrink by 6.9% this year and grow by 4.1% in 2021.

World goods trade decreased by more than 10% between March and April this year. Of the major economic regions, the euro area experienced the sharpest fall in imports this spring. However, the trade in goods returned to growth in June. Driven by a growth in activities and demand, goods trade will grow during the outlook period. World trade will contract by 10.3% this year and grow by 6.5% in 2021.

Both short-term market rates and interest rates on government loans are at historic lows. Short-term interest rates have decreased after a short rise in spring. A moderate rise in interest rates is expected at the end of the outlook period. The low inflation reflects the overall sluggishness of the economy.

Exports will continue to shrink during the rest of the year

Finland's gross domestic product is expected to contract by 4.5% in 2020. The fall in output was steepest in the second quarter, a result of the domestic measures to contain the pandemic. The economy will pick up in July-September compared with the previous quarter and the year-on-year contraction will be smaller than in the second quarter.

Finnish exports are expected to decrease by about 13%, which is the single most important factor contributing to the fall in GDP. The uncertainty arising from the pandemic is slowing down demand in many of Finland's key export markets, which will further decrease exports in 2020.

Private consumption will decline by 3.8% in 2020. Consumption of services has been hardest hit by the restrictions on mobility and business activities prompted by the pandemic. There was only a moderate decrease in the consumption of durables in the first half of the year, and the consumption of non-durables (including food and energy) actually increased year on year.

Private investments will contract by 7.6% in 2020. Growth in investments will be at its slowest in the third quarter of the year but the sluggish growth will persist until the end of 2020. However, there have been more positive signs in the construction sector than previously anticipated. There will be a slight decrease in housing starts in 2020. However, the number of housing starts is expected to decline in the second half of the year and thus, housing construction investments are expected to fall by 2.0% this year. In an uncertain situation, investments in machinery and transport equipment will fall substantially in 2020.

At the moment, there is little demand for labour force in the labour market because the number of persons outside the labour force increased during the first half of the year. Hidden unemployment in particular is higher than in 2019. The number of employed persons will decrease more rapidly in 2020. Employment will contract by 2% and the employment rate will fall to 71.2%. Decrease in employment and the large number of layoffs will increase the unemployment rate to 8 per cent.

A large number of new collective agreements were concluded in the first half of the year. On average, nominal wages will rise by almost 1.5% under the agreements. Earnings will increase by 1.7% this year and wage drifts will be small.

Measured on the basis of the consumer price index, an inflation rate of 0.4% is forecast for 2020. Substantial decrease in consumer demand and an uncertain economic outlook will also slow down inflation in the coming years.

The GDP is expected to grow by 2.6% in 2021 and by 1.7% in 2022. The recovery of industries in our key trading partners is essential for Finnish exports. Tourism remains at a standstill and the outlook for 2021 is weak. ICT and business services are the largest items in Finland's service exports and the outlook for them is better than for sectors that are directly hit by restrictions on mobility and risks affecting consumer confidence.

Consumption of goods is expected to return to normal levels in 2021. Cautiousness among consumers is also expected to impact the consumption of services next year and as a result, foreign travel in particular will remain at lower-than-normal levels. The household savings rate will remain positive throughout the outlook period as consumption will remain lower than disposable income.

Growth in private investments will remain weak in the coming years. On average, private investments will decrease by 1.1% in the outlook period, which means that their ratio to GDP will be about 19% at the end of the period.

Housing starts will fall by several thousand by the year 2021, which will also mean lower investments in housing construction in 2021. The decline in housing construction investments will come to an end in 2022.

Stronger demand both domestically and internationally towards the end of the outlook period will boost investments in machinery and equipment. Research and development expenditure will fall at the start of the outlook period, but after that it will increase throughout the period. Government R&D funding will increase in 2020 and 2021.

Domestic consumption will pick up already during the second half of the year, which will help imports to recover. At the same time, lower output in export companies will reduce the demand for imported components, while sluggish growth in investments from 2021 onwards will also slow down growth in imports.

The expected economic recovery will gradually boost demand for labour in 2021 and 2022. Due to the weak first half of the year, the number of employed persons will decrease slightly in 2021 and start picking up in 2022. However, the number of employed persons will remain substantially below 2019 levels and the employment rate will stand at 71.5% in 2022.

A higher level of economic activity and employment will probably lead to higher wage drifts in 2021 and 2022. Moreover, the private and public sector wage rises agreed for 2021 are about 0.5 percentage points higher. Nominal earnings are expected to increase by 2.5% in 2021 and by 2.0% in 2022.

The national consumer price index is expected to rise by 1.2 % in 2021 and by 1.4 % in 2022. Tax increases targeting consumption will boost inflation in both years, particularly in 2021.

Deficits in general government finances will persist

Finland's general government deficit will reach 7.7% this year, while general government debt will increase to about 70% of the GDP. Public finances are weakened by the economic downturn triggered by the COVID-19 pandemic and the Government measures supporting companies, citizens and economic growth.

Even though the general government deficit will shrink in the next few years, it will still amount to 2.7% of the GDP (about EUR 7 billion) in 2024. The combined deficit of central and local government will be larger because the employment pension institutions, which are part of general government, will post slight surpluses.

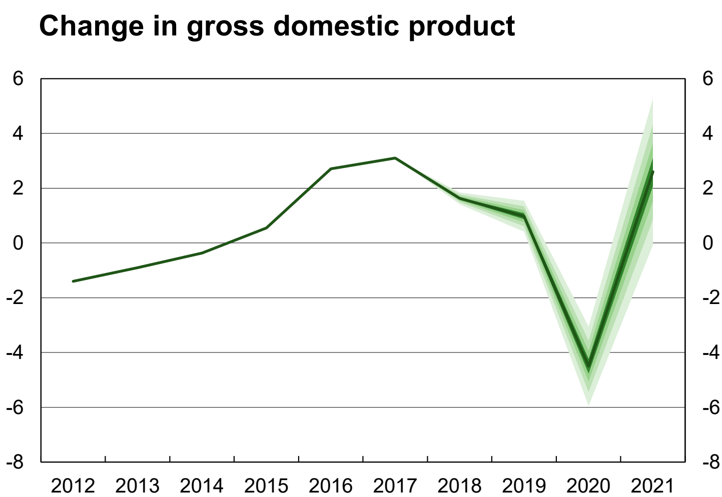
Finland's general government finances already suffered from a structural deficit during the peak of the economic cycle preceding the downturn. Our general government finances have been substantially weakened by the ageing of the population for the last ten years as the number of ageing people using public services and benefits has been growing at a rapid rate. At the same time, the working-age population financing Finland's public services and social security with its taxes has started to shrink.

The ageing of the population will also cause expenditure pressures in general government finances in the future as the number of people aged over 75 (major users of health and social services) will grow. As a result, the general government debt-to-GDP ratio will probably grow throughout the 2020s. According to the current estimates, Cconsolidating general government finances by EUR 5 billion by the year 2026 would stabilise the debt ratio to between 70 and 75 per cent during the next ten years. Restoring the debt ratio to 2019 levels (around 60%) during the 2020s would require consolidation measures totalling about EUR 10 billion.

Uncertainty of economic outlook

There is a great deal of uncertainty in the economic outlook in both Finland and in the world as a whole. The COVID-19 situation in Finland has remained under control and the assumption in the forecast is that this will also remain the case. Consumer confidence and economic performance will remain weak as long as there is no effective coronavirus treatment or vaccine. A significant increase in coronavirus cases during the autumn would cause more uncertainty among economic agents and weaken economic growth even if no additional restrictions are introduced.

Chart below shows the uncertainty of economic forecasts as a confidence interval based on past forecasting errors and built around the forecast. According to this confidence interval, there is an 80 per cent probability that Finland's GDP will contract by between 3 and 6 per cent this year. The confidence interval for the next year's forecast is wider. The likelihood that GDP growth will be between 0% and 5% in 2021 is 80 per cent. The economic growth rate may also fall outside the confidence interval, especially because the estimates of this year's growth are associated with an unprecedented degree of uncertainty.



A new outbreak of the COVID-19 epidemic is the key downside risk in the forecast. The economic impacts of the second wave would depend on the public sector measures to contain the epidemic and to support the economy and the impacts of these measures on consumers making spending decisions. If the economy has not yet fully recovered before the second wave, the contraction may be less severe than what was experienced in spring. However, in that case, the economic growth potential will be more limited, and the crisis will have longer-term impacts.

Early introduction of vaccines or treatments might also speed up the recovery. In particular, it would help services to recover more rapidly and more strongly, both in Finland and internationally.

Major efforts to stimulate output and demand have been launched in the EU and additional action is planned. The implementation of these measures as well as the economic stimulus package presented by the Finnish Government in June will have a positive impact on output in Finland and elsewhere this year and in 2021.

Finland's recovery may also be slowed down by an international investment recession if a large number of companies are destroyed before the growth resumes. Moreover, cautiousness among consumers may produce another surprise during the autumn.

Table 1. **Key forecast figures**

	2019	2017	2018	2019	2020**	2021**	2022**
	EUR bn	change in volume, %					
GDP at market prices	241	3.3	1.5	1.1	-4.5	2.6	1.7
Imports	95	4.2	5.5	2.4	-10.0	4.0	2.8
Total supply	**336**	**3.5**	**2.6**	**1.5**	**-6.1**	**3.0**	**2.0**
Exports	96	8.6	1.7	7.5	-12.5	5.3	3.8
Consumption	181	0.7	1.7	1.0	-1.5	3.1	0.8
private	126	1.0	1.8	0.9	-3.8	4.0	1.6
public	55	0.1	1.6	1.2	3.9	1.1	-1.1
Investment	57	4.8	3.9	-1.0	-4.7	-0.0	2.9
private	47	5.7	3.7	-1.5	-7.6	0.2	4.2
public	10	0.5	5.0	1.3	8.7	-0.9	-2.6
Total demand	**336**	**3.5**	**2.5**	**1.8**	**-5.8**	**3.2**	**2.2**
domestic demand	240	1.8	2.8	-0.3	-3.1	2.5	1.6

Table 2. Other key forecast figures

	2017	2018	2019	2020**	2021**	2022**
GDP, EUR bn	226	234	241	233	242	250
Services, change in volume, %	2.6	2.4	1.2	-3.6	2.7	1.4
Industry, change in volume, %	8.6	-2.0	3.7	-6.8	3.4	3.6
Labour productivity, change, %	3.0	-1.0	0.2	-0.6	1.8	1.5
Employed labour force, change, %	1.1	2.6	1.1	-2.0	-0.5	0.5
Employment rate, %	69.6	71.7	72.5	71.2	71.0	71.5
Unemployment rate, %	8.6	7.4	6.7	8.0	8.2	8.0
Consumer price index, change, %	0.7	1.1	1.0	0.4	1.2	1.4
Index of wage and salary earnings, change, %	0.2	1.7	2.1	1.7	2.5	2.0
Current account, EUR bn	-2.1	-4.0	-1.1	-1.2	-2.7	-1.5
Current account, relative to GDP, %	-0.9	-1.7	-0.5	-0.5	-1.1	-0.6
Short-term interest rates (3-month Euribor), %	-0.3	-0.3	-0.4	-0.4	-0.4	-0.3
Long-term interest rates (10-year govt. bonds), %	0.5	0.7	0.1	-0.2	-0.1	-0.1
General government expenditure, relative to GDP, %	53.7	53.4	53.3	59.8	57.6	56.0
Tax ratio, relative to GDP, %	42.9	42.4	42.2	41.9	42.7	42.3
General government net lending, relative to GDP, %	-0.7	-0.9	-1.0	-7.7	-5.0	-3.9
Central government net lending, relative to GDP, %	-1.8	-1.2	-1.2	-7.2	-4.4	-3.2
General government gross debt, relative to GDP, %	61.3	59.6	59.2	70.2	72.8	74.3
Central government debt, relative to GDP, %	46.8	44.9	44.2	53.3	55.6	56.6

Medium-term outlook 2023–2024

The Finnish economy will contract sharply this year as a result of the COVID-19 pandemic and the measures taken to contain it. A recovery will follow in 2021 and 2022 and the pre-crisis GDP levels will be achieved in 2023. In the medium term (in the years 2023 and 2024), economic growth will slow down but will nevertheless substantially exceed potential output growth[1].

A reduction in labour input will weaken potential output this year. In the coming years, labour input will decline further as the working-age population shrinks and there is no longer any improvement in the participation rate. Structural unemployment also limits the increase in labour input. As a result of the downturn,

1 The medium-term economic outlook can be estimated on the basis of the potential output, which is considered to define the growth prerequisites for the economy. In its assessments of potential output, the Ministry of Finance uses the production function method jointly developed by the European Commission and EU Member States, in which potential output growth is divided into projections of potential labour input, capital and total factor productivity. Potential output and output gap are latent variables, the assessment of which involves uncertainties, especially during a strong economic cycle and under conditions of rapid changes in the production structure.

unemployment will grow and may partially turn into a structural problem as unemployment periods become longer.

In addition to labour input, the production conditions of the economy are also influenced by the capital stock. As a result of the downturn and uncertain outlook, investment rate will fall, which will slow down potential output growth. Growth in capital stock will boost potential output by less than 0.5% each year.

Total factor productivity is the third source of potential output growth. It has been growing more rapidly in recent years even though in historic terms, growth remains weak. The weak growth can be explained by the structural changes in the Finnish economy. The output of high-productivity sectors has declined, and services have become more predominant in the overall structure of the economy. Total factor productivity growth trend is expected to be just over 0.5% in the medium term, which can be compared with an average annual growth of more than two per cent in the early years of the 2000s.

The positive output gap is expected become highly negative this year. The negative output gap will be reduced in the coming years as the economy is growing faster than potential output. The output gap will close in 2024 when the cyclical situation is estimated to be neutral. The downturn will slow down potential output growth as a result of lower investment levels, lower labour market participation and rising unemployment. Furthermore, the decline in working-age population will gradually slow down growth in the medium term.

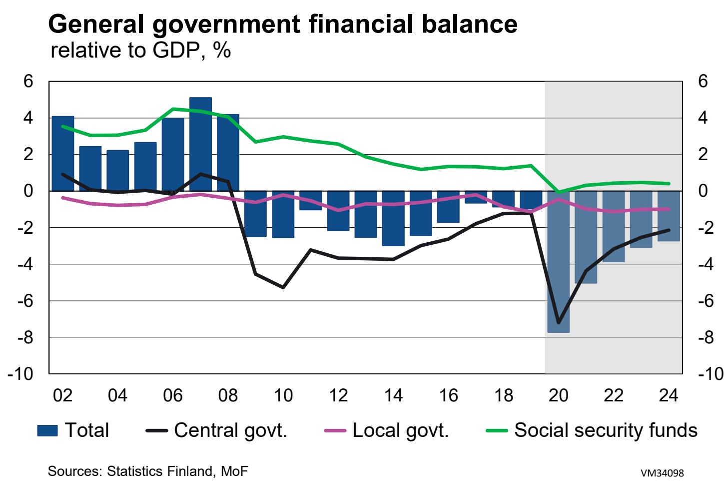
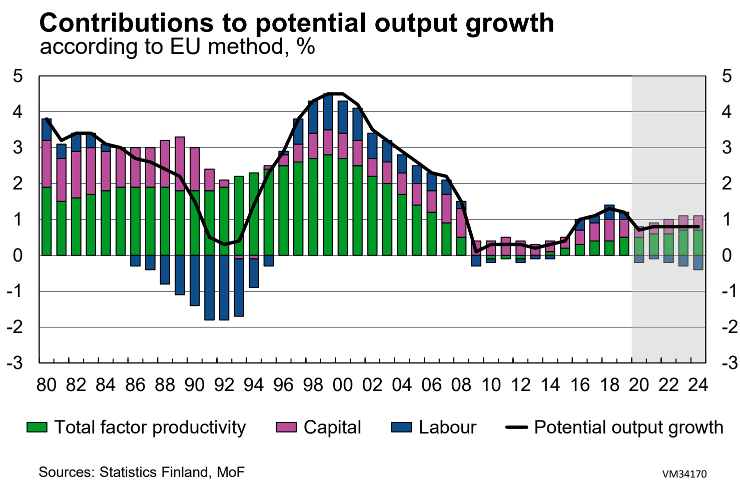


Table 3. Key forecast figures for the medium term

	2019	2020**	2021**	2022**	2023**	2024**
GDP at market prices, change in volume, %	1.1	-4.5	2.6	1.7	1.6	1.5
GDP, EUR bn	241	233	242	250	259	269
Consumer price index, change, %	1.0	0.4	1.2	1.4	1.5	1.6
Unemployment rate, %	6.7	8.0	8.2	8.0	7.8	7.6
Employment rate, %	72.5	71.2	71.0	71.5	71.8	71.9
General government net lending, relative to GDP, %	-1.0	-7.7	-5.0	-3.9	-3.1	-2.7
Central government	-1.2	-7.2	-4.4	-3.2	-2.5	-2.1
Local government	-1.1	-0.4	-1.0	-1.1	-1.0	-1.0
Social security funds	1.4	-0.1	0.3	0.4	0.5	0.4
Structural balance, relative to GDP, %	-1.7	-5.3	-3.6	-3.0	-2.6	-2.7
General government gross debt, relative to GDP, %	59.2	70.2	72.8	74.3	75.3	76.0
Central government debt, relative to GDP, %	44.2	53.3	55.6	56.6	57.5	57.9
Output gap, % of potential output[1]	1.0	-4.1	-2.4	-1.6	-0.7	-0.0

[1] Estimated according the method developed jointly by the EU Commission and Member States



THE EU STIMULUS PACKAGE

In addition to national stimulus measures, the EU has also introduced a number of measures in response to the economic impacts of the COVID-19 pandemic. For exam-ple, in spring 2020, state aid rules were temporarily relaxed, and the Union decided to grant loans to support short time working arrangements (SURE scheme), opened a credit line as part of the European Stability Mechanism and established a guarantee fund that aims at mobilising EUR 200 billion through the European Investment Bank. In July, the European Council agreed on the Multiannual Financial Framework of the European Union covering the period 2021-2027 and on a recovery instrument (Next Generation EU).

The recovery instrument totals EUR 750 billion (at 2018 prices). A total of EUR 390 billion of this sum would be provided to the Member States in grants and the remaining EUR 360 billion in loans. Most of the grants (EUR 312.5 billion) and all loans would be channelled to the Member States through the Recovery and Resilience Facility (RRF) set up as part of the recovery instrument.[1] According to preliminary estimates (which are partially based on forecasts) Finland would receive a total of about EUR 3.1 billion in grants, most of which would come from the RRF. According to the calculations produced by the Ministry of Finance Economics Department, which are based on the summer forecast of the European Commission, the RRF grants would account for about EUR 2.3 billion of the total (at 2018 prices).

Finland's imputed contribution to the aid granted from the recovery instrument (at 2018 prices) would be about EUR 6.6 billion (1.7% of EUR 390 billion). The recov-ery instrument would be funded by increasing the flexibility of the EU budget and with the borrowing by the European Commission guaranteed by it. The imputed con-tribution to the RRF (at 2018 prices) would be about EUR 5.3 billion (plus interest payments and expenses). Finland's share of the expenses and interest payments is not yet known as no details are available of the interest rate risk management strategy used in the financing of the recovery instrument.

The overall objective of the RRF is to promote the economic, social and regional cohesion of the European Union by improving the resilience of the Member States, by mitigating the social and economic impacts of the crisis and by supporting green and digital transition of the economy. Achieving these objectives would strengthen employment and output potential in the Member States after the coronavirus pandemic and support sustainable growth. In order to ensure that the objectives are achieved, the

1 The remaining EUR 77.5 billion would be distributed to the Member States from other programmes as follows: EUR 47.5 billion, REACT-EU; EUR 10 billion, Just Transition Fund; EUR 7.5 billion, Rural Development; EUR 5.6 billion, InvestEU; EUR 5 billion, Horizon Europe; and EUR 1.9 billion, RescEU.

RRF would support structural reforms and investments in the Member States by granting funding for them.

The reforms and investments would be made into coherent packages that are presented in national recovery and resilience plans. The grants and loans provided to the Mem-ber States would be based on these plans. The European Commission would assess the plans on the basis of jointly agreed criteria and consider the general objectives of the RRF in the process. The plans would have to contain detailed information on costs and progress of the projects because the grants would be paid in accordance with the progress of the reforms and investment projects. The plans would have to be approved by the EU Council.

The recommendations issued by the EU for the Member States and the euro area as well as national priorities would serve as an important factor defining the structural reform and investment packages. The reforms would also be guided by the joint strategic goals of the EU (green transition and digitalisation) and 37% of the RRF would go to supporting green development and 20 % to supporting digitalisation. The focus in the country-specific recommendations for the year 2020 is on mitigating the im-pacts of the coronavirus crisis but the recommendations for 2019 are also taken into account in the RRF. The country-specific recommendations for Finland concern such matters as the health and social services reform (resilience of the health care system), employment policy, and investments in green transition, digital change, and research and innovation.

A total of 70% (about EUR 218.8 billion) of the commitments for the grants paid from the RRF would be made for the years 2021 and 2022, and 30% (about EUR 93.8 bil-lion) for the year 2023. The grants provided from the RRF in 2021 and 2022 would be based on the allocation criteria of the European Commission, taking into account the standard of living, population and the average of the unemployment rate for the period 2015–2019 compared to the EU average of the Member States. Under the allocation criteria for the year 2023, the unemployment criterion would be compensated on an equal basis with the loss in real GDP determined in 2020 and with the cumulative loss in real GDP determined in 2020 and 2021. The amounts of the grants provided in 2023 would be approved based on the criteria above by the end of June 2022.

In addition to the grants, Member States would also receive loans from the RRF. A Member State would be eligible for the loans if the financing needs for the reforms and investments set out in its recovery and resilience plan exceed the maximum amount of the grants specified for each Member State calculated on the basis of the allocation criteria described above. As a rule, the maximum amount of loans granted to each Member State would be 6.8% of its gross domestic product and the total amount of the loans would be EUR 360 billion.

Planning of the use of the recovery instrument at national level has begun. At its budget session, the Government outlined the priorities of Finland's recovery and resil-ience plan and made decisions on further preparations of the plan. Recommendations issued by the EU and national needs are reflected in the priorities. They concern the labour market, health and social services, education, training, research and innovation, sustainable infrastructure and digitalisation, international competitiveness and support for green transition.

Negotiations on the RRF regulation are still continuing in the EU but the European Commission has expressed the hope that it would start receiving preliminary recovery and resilience plans from the Member States in mid-October. The aim is that the RRF would be fully operational at the start of 2021 and that the first grants could be provided soon after that.

1 Economic outlook

1.1 Global economy

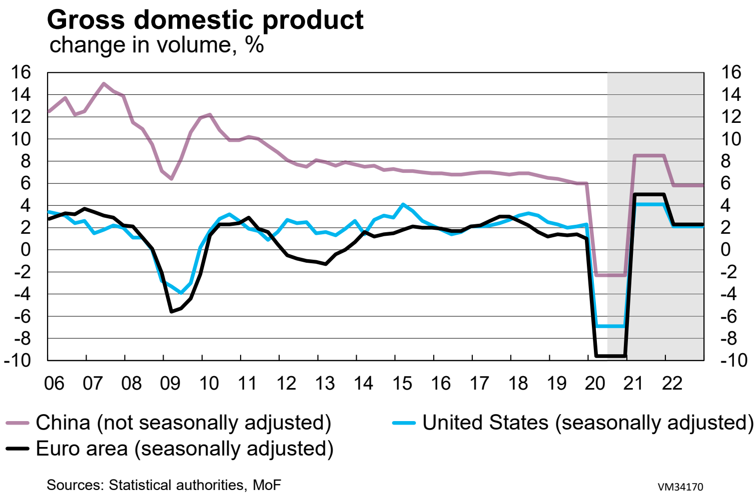
Recovering from a deep global downturn

The COVID-19 pandemic plunged the world economy into a deep downturn but there are many indicators suggesting a recovery in the third quarter of the year. At the same time, however, the second wave of the pandemic is raising its head in a number of countries, which adds to the uncertainty. The global economy will contract by 6.1% in 2020 and will grow by 5.5% next year.

There was a sharp contraction in the Chinese economy in the first quarter of this year when the pandemic was at its most difficult stage. However, tough measures to contain its spread produced results and the economy has been on the mend since the second quarter. Consumers remain cautious, however. The GDP will contract by 2.3% this year and will grow at a rate of 8.5% in 2021.

The euro area economy contracted by almost 12% in the second quarter of 2020 from the previous quarter. The service sector has been hit particularly hard by the restrictions imposed by national governments. However, according to leading indicators, the outlook will start improving in the third quarter. The EUR 750 billion stimulus programme outlined by the EU will give a boost to the economic recovery. The euro area economy will contract by 9.6% this year and grow by 5% in 2021.

The United States is still in the grip of a severe COVID-19 epidemic, but the number of new cases has decreased. Total output contracted by more than 9% in the second quarter from the previous quarter, a result of the measures taken to contain the pandemic. Unemployment increased at an unprecedented rate. However, the extensive stimulus measures introduced by the federal government is boosting the level of activity and the economy will start recovering in the third quarter. However, due to social instability, the recovery is on a fragile basis. This uncertainty is reflected in the weakening of the US dollar in recent weeks. Total output will shrink by 6.9% this year, followed by a growth of 4.1% in 2021.

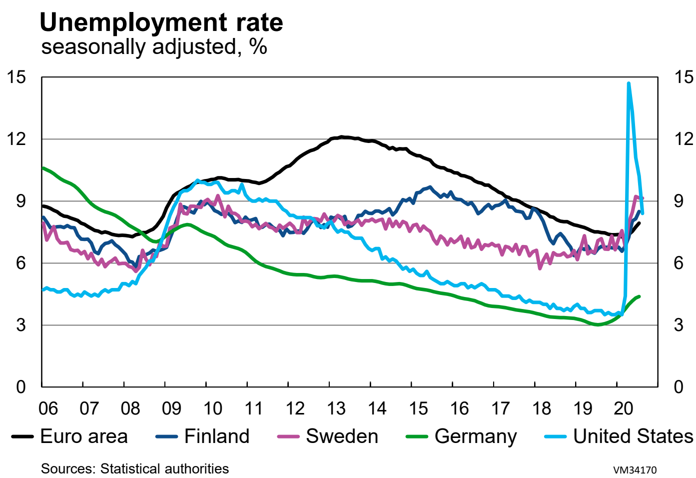


In Japan, the number of new infections is now higher than in spring, which casts a shadow over the economic outlook. A sharp contraction in private consumption caused the level of activity to fall in spring but there are now signs of higher consumer confidence. The outlook is weakened by modest potential growth of the economy. Total output will shrink by 6.2% this year, followed by a growth of 2.6% in 2021.

In the spring, the economy of the United Kingdom contracted by about 20% from the previous quarter, which was unprecedented. The sharp decline was due the service-oriented nature of the UK economy. Economic recovery is overshadowed by uncertainty over the Brexit. The economy will contract by almost 10% this year and grow at a rate of 4.4% in 2021.

In addition to the pandemic, the outlook for the Russian economy is also weakened by relatively low crude oil prices. The limits on oil output agreed with OPEC in spring have also slowed down the level of activity. The Russian government will continue its economic stimulus programme until the end of 2021, drawing on substantial financial buffers. Total output will shrink by 6.4% this year, followed by a growth of 3.3% in 2021.

Despite fewer restrictions, Sweden experienced a sharper economic contraction in the second quarter than Denmark or Norway. Leading indicators suggest that the economy has been on the mend since summer. The economy will contract by 6.6% this year, followed by a growth of 4.5% in 2021.



Interest rates will remain low for the foreseeable future

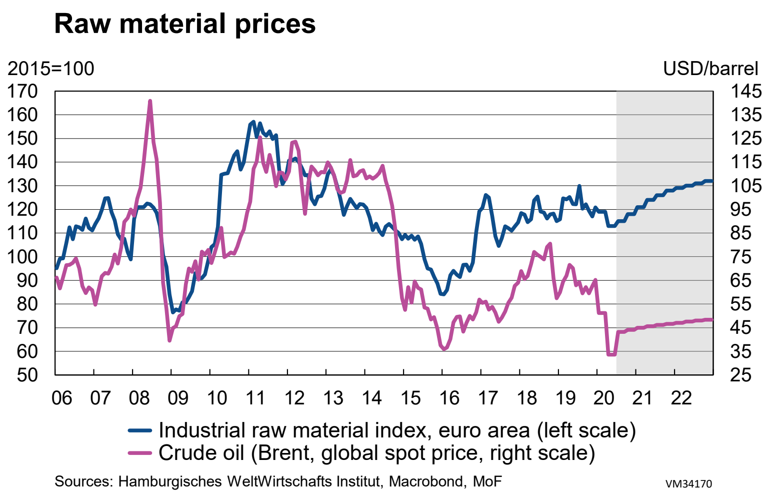
Both short-term market rates and interest rates on government loans are at historic lows and no changes are expected in them in the foreseeable future. Short-term interest rates have decreased after a short rise in the spring. The interest gap between German government loans and government loans elsewhere in the euro area has narrowed. A moderate rise in interest rates is expected at the end of the outlook period.

Inflation remains modest

Inflation has been slow for many years, especially in developed countries. There are few signs of any price increases during the outlook period either and the price stability targets of key central banks are distant. Low inflation reflects the sluggishness of the economy.

Moderate increases in raw material prices

After a turbulent spring, crude oil prices have risen only moderately during the past few months. The agreement between Russia and OPEC countries on limiting the output is being gradually dismantled. Futures suggest a slight increase in crude oil prices in the outlook period. There have been slight increases in industrial raw material prices during the summer months, indicating that the output is on the increase again.



Positive outlook for world trade after the collapse experienced in spring

World goods trade decreased by more than 10 per cent between March and April this year. Of the major economic regions, the euro area experienced the sharpest fall in imports this spring. However, the trade in goods returned to growth in June. Driven by a growth in activities and demand, goods trade will grow during the outlook period. World trade will contract by 10.3% this year, followed by a growth of 6.5% in 2021.

Risks are still skewed to the downside

A second wave of the COVID-19 pandemic is the key downside risk in the outlook. There are already signs of this in some European countries. A second wave would slow down the level of activity and postpone economic recovery. Collapse of the Brexit negotiations would add to uncertainty in Europe. The social situation in the United States remains unstable in the election year and any escalation would dampen the global economic outlook. Quicker-than-expected abatement of the pandemic due to an effective vaccine is the key positive risk.

Table 4. Gross domestic product

	2017	2018	2019	2020**	2021**	2022**
	change in volume, %					
World (PPP)	3.8	3.6	2.9	-6.1	5.5	3.3
Euro area	2.7	1.9	1.3	-9.6	5.0	2.3
EU	2.5	1.9	1.4	-8.9	4.7	2.1
Germany	2.9	1.3	0.6	-9.4	4.9	2.2
France	2.4	1.8	1.5	-10.6	5.2	2.4
Sweden	2.8	2.1	1.2	-6.6	4.5	2.2
United Kingdom	1.9	1.3	1.5	-9.7	4.4	1.9
United States	2.3	3.0	2.3	-6.9	4.1	2.1
Japan	2.2	0.3	0.7	-6.2	2.6	0.9
China	6.9	6.7	6.1	-2.3	8.5	5.8
India[1]	7.0	6.1	4.2	-4.7	6.0	6.2
Russia	1.8	2.5	1.3	-6.4	3.3	1.8

[1] Fiscal year
Sources: Eurostat, statistical authorities, IMF, World Bank, MoF

Table 5. Background assumptions

	2017	2018	2019	2020**	2021**	2022**
World trade growth, %	5.3	3.7	-0.4	-10.3	6.5	3.4
USD/EUR	1.13	1.18	1.12	1.14	1.18	1.17
Industrial raw material price index, EA, € (2015=100)	114.5	118.5	122.1	116.3	124.8	130.5
Crude oil (Brent), $/barrel	54.8	71.6	64.1	43.0	45.9	47.8
3-month Euribor, %	-0.3	-0.3	-0.4	-0.4	-0.4	-0.3
Government bonds (10-year), %	0.5	0.7	0.1	-0.2	-0.1	-0.1
Export market share (2010=100)[1]	95.0	93.0	100.0	98.0	97.0	97.0
Import prices, %	3.8	3.4	0.4	-4.9	1.4	1.6

1 Ratio of export growth to world trade growth
Sources: Statistical authorities, CPB, HWWI, Reuters, MoF

1.2 Foreign trade

As a result of the pandemic, world trade contracted sharply, and international mobility of people came to an almost complete halt in the second quarter of 2020. During the summer months, economic indicators started pointing upwards in many of Finland's key export markets, but this autumn is expected to be difficult. The uncertainty arising from the pandemic is slowing down international demand in many of Finland's key export sectors. Industrial orders also declined in Finland's exports markets in the second quarter and the order stock remains low in Finnish export companies in many sectors. For the Finnish foreign trade, this means a slow recovery and faster growth can only be expected in the coming years. However, the volume of the foreign trade will remain below 2019 levels throughout the outlook period.

1.2.1 Exports and imports

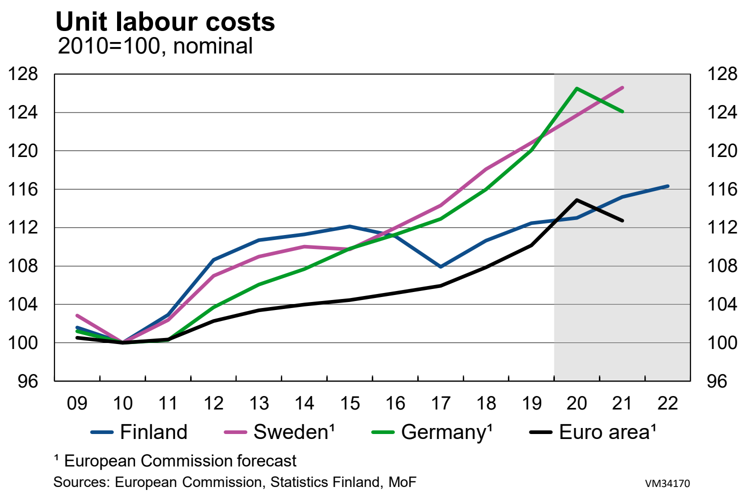
Exports will contract by 12.5 % in 2020 and recovery will be slow in the coming years: exports will grow by 5.3 % in 2021 and by 3.8 % in 2022. The volume of goods and service exports already decreased in the first quarter of 2020. There was a sharp fall in the exports of services in the second quarter as tourism and transport services were hit particularly hard by the mobility restrictions. At the same time, goods exports decreased only moderately compared with the fall in export demand in Finland's key export markets. Exports are expected to grow at a slow rate during the last months of 2020 and higher growth rates will only be registered in the coming years.

Most of the goods exports are supplied to meet industrial production needs, while capital goods and transport equipment have accounted for about one third of the value of Finnish exports in recent years. Typically, in a downturn, the demand for capital goods recovers more slowly than the demand for consumer products. For this reason, the recovery of industries in our key trading partners is essential for Finland's exports. Tourism remains at a standstill and the outlook for 2021 is weak. ICT and business services are the largest items in Finland's service exports and the outlook for them is better than for sectors that are directly hit by restrictions on mobility and risks affecting consumer confidence.

Volume of imports will shrink by 10 % in 2020 and grow by 4 % in 2021 and by 2.8 % in 2022. Imports of both goods and services decreased during the first half of the year and the growth rates will remain low during the last months of the year. Domestic consumption will already pick up during the second half of the year, which will help imports to recover. At the same time, lower output in export companies will reduce the demand for imported components, while sluggish growth in investments from 2021 onwards will also slow down growth in imports.

Table 6. Foreign trade

	2017	2018	2019	2020**	2021**	2022**
	change in volume, %					
Exports of goods and services	8.6	1.7	7.5	-12.5	5.3	3.8
Imports of goods and services	4.2	5.5	2.4	-10.0	4.0	2.8
	change in price, %					
Exports of goods and services	3.4	4.2	-0.3	-4.5	1.3	1.5
Imports of goods and services	3.8	3.4	0.4	-4.9	1.4	1.6



1.2.2 Prices and current account

Both export and import prices of goods fell sharply in the first half of 2020, and the prices will increase moderately during the last months of the year. The prices of raw materials and oil fell sharply in the first quarter of the year, which was also reflected in prices in a number of sectors. However, the prices of industrial raw materials have been rising since April, but the price of oil has remained at a lower level.

Terms of trade weakened in the first quarter of 2020 but boosted by a sharp fall in the import prices of goods, the ratio strengthened in the second quarter. In 2021, both export and import prices will rise again at a moderate rate and the growth will continue towards the end of the outlook period.

The value of exports and imports will decrease at the start of the outlook period as both volumes and prices fall. The value of exports will decline slightly faster than imports in 2020, especially as exports will fall towards the end of the year, which will temporarily widen the current account deficit. However, in the years after that, a slight improvement in the current account is expected. The current account will remain negative until the end of the outlook period, but the deficit will narrow in 2022.

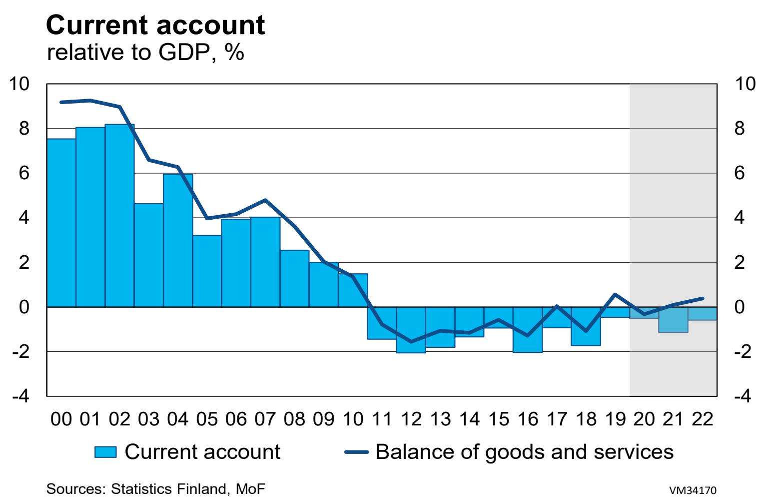


Table 7. Current account

	2017	2018	2019	2020**	2021**	2022**
	EUR bn					
Balance of goods and services	0.1	-2.5	1.4	-0.7	0.2	1.0
Factor incomes and income transfers, net	-2.2	-1.5	-2.5	-0.4	-3.0	-2.4
Current account	-2.1	-4.0	-1.1	-1.2	-2.7	-1.5
Current account, relative to GDP, %	-0.9	-1.7	-0.5	-0.5	-1.1	-0.6

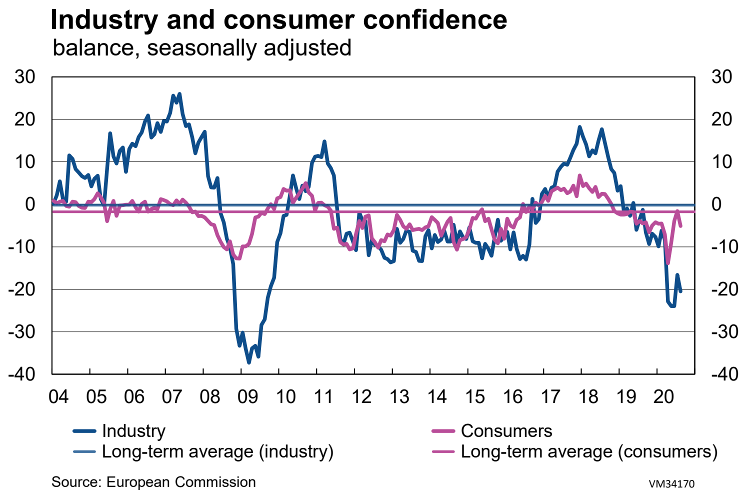
1.3 Domestic demand

1.3.1 Private consumption

Private consumption will recover quickly

In the second quarter of this year, private consumption decreased by 6.9% from the previous quarter and by 10.9% year on year. This decrease in consumption caused by the COVID-19 pandemic is the largest quarterly drop since 1990.

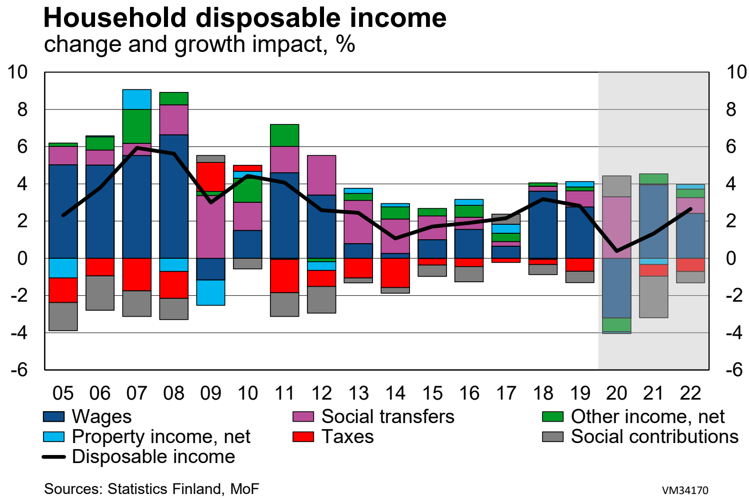
During the second quarter, the consumption of services decreased slightly more than anticipated and was 15% below the previous year's levels. On the other hand, consumption of durables fell considerably less than anticipated and consumption of non-durables (including food and energy) increased slightly year on year.



According to Statistics Finland's confidence survey, consumer confidence returned to normal in July-August. First registrations of cars also returned to near-normal levels in July. Preliminary data collected from the Incomes Register on wage bill trends suggest that the wage bill returned to last year's level in July. The volume of retail sales increased in July by 4% year on year.

The consumption of services is expected to return to a growth path in the third quarter, after the opening of restaurants at the start of June. Consumption will return to normal more slowly in services related to foreign travel, sports and cultural events, which have been particularly hard hit by cautiousness among consumers. The consumption of services is expected to decrease by almost 6% in 2020.

Figures from the summer months suggest that consumers are now purchasing durables at the same rate as in the past, but due to the weak first months of the year, consumption of durables is expected to decrease by almost 4% this year. The consumption of semi-durables goods, such as clothing and footwear, is expected to decrease by more than 7% in 2020 as a result of the exceptionally weak first half of the year. However, a rapid recovery is expected during the last months of the year.



Cautiousness among consumers does not have an equally negative impact on the consumption of non-durables, even though fuel consumption will probably be lower than in 2019, as remote work has become more common. The consumption of non-durables will increase by just over one per cent this year as the grocery trade benefits from the decrease in restaurant visits.

Private consumption will decline by 3.8% in 2020. When the financial crisis hit Finland in 2009, private consumption fell by 2.9%.

In 2021, private consumption is expected to grow by 4% as the consumption of goods returns to normal. Cautiousness among consumers is also expected to impact the consumption of services next year and as a result, foreign travel in particular, will remain at lower-than-normal levels.

In 2022, consumption growth will slow down to 1.6%. The household savings rate will remain positive throughout the outlook period as consumption will remain lower than disposable income.

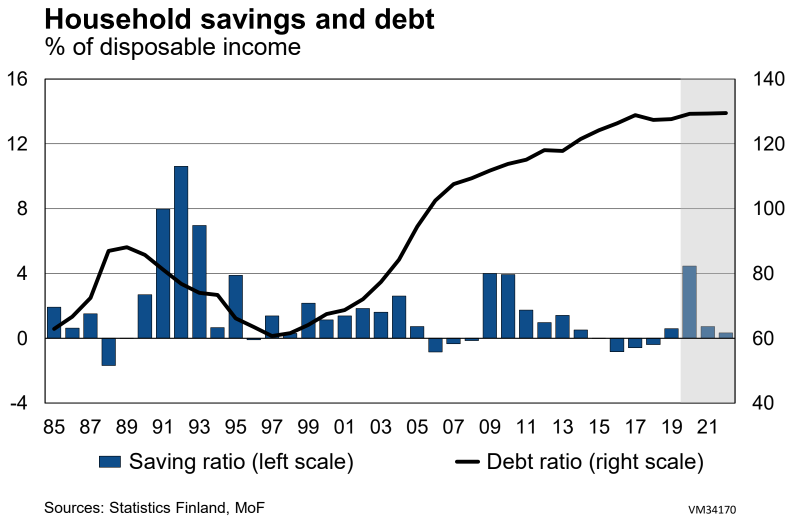


Table 8. Consumption

	2019	2017	2018	2019	2020**	2021**	2022**
	share, %	change in volume, %					
Private consumption	100.0	1.0	1.8	0.9	-3.8	4.0	1.6
Households	95.4	1.1	1.9	0.9	-3.9	4.0	1.7
Durables	7.7	4.0	4.5	3.2	-3.7	4.8	3.1
Semi-durables	7.5	2.2	2.3	2.4	-7.5	8.4	2.8
Non-durable goods	27.0	-0.1	0.3	-0.8	1.4	0.3	0.7
Services	53.3	1.8	2.4	1.7	-5.9	5.2	1.7
Consumption by non-profit institutions	4.3	-1.1	-1.3	-0.3	-3.0	3.0	1.0
Public consumption		0.1	1.6	1.2	3.9	1.1	-1.1
Total		**0.7**	**1.7**	**1.0**	**-1.5**	**3.1**	**0.8**
Households´ disposable income		2.2	3.2	2.8	0.4	1.3	2.7
Private consumption deflator		0.8	1.1	1.0	0.4	1.2	1.4
Households´ real disposable income		1.4	2.1	1.8	0.0	0.1	1.2
		%					
Consumption in relation to GDP (at current prices)		76.1	75.8	75.4	77.8	78.1	77.4
Household savings ratio		-0.6	-0.4	0.6	4.5	0.7	0.3
Household debt ratio[1]		128.9	127.4	127.6	129.3	129.4	129.5

[1] Household debt at end-year in relation to disposable income.

1.3.2 Public consumption

The largest items in public consumption expenditure are personnel expenses, and goods and services purchased. Local government consumption accounts for about two thirds and central government for one quarter of public consumption, while consumption by social security funds makes up the remainder. Growth in public consumption expenditure in 2019 was at long-term average.

Public consumption expenditure will grow at a substantially faster rate this year. The growing need for services arising from the ageing of the Finnish population and the front-loaded spending increases introduced by Prime Minister Marin's Government will boost the growth in public consumption expenditure. In 2020, consumption will also be boosted by the public-sector inputs arising from the COVID-19 pandemic, restrictions affecting payment and sales revenue, and the support and stimulus measures introduced by the Government. This year, public consumption expenditure-to-GDP ratio will exceed 25% but will decrease moderately between 2021 and 2024. The ratio has also grown sharply during previous economic crises.

The value of public consumption expenditure will grow throughout the outlook period, but as the inputs targeting 2020 are coming to an end, growth will be considerably slower than this year. The increase in public consumption expenditure in 2021 will be sustained by the tackling of the health care treatment backlog postponed from the current year, COVID-19 testing and tracing required by the hybrid strategy and the public sector wage increases, most of which will be paid next year.

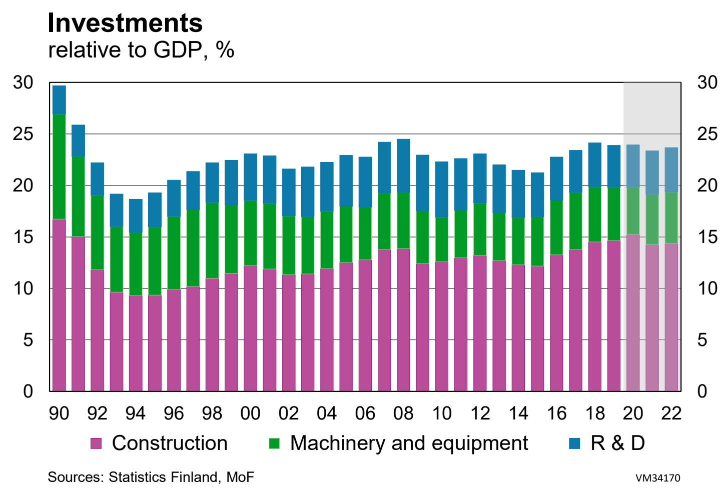
1.3.3 Private investment

The investment environment is still characterised by uncertainty

Instability of the global economy and weak growth in Finland's export markets will make companies less willing to launch investments this year. However, there have been more positive signs in the construction sector than previously anticipated.

According to the latest figures, private investments decreased by 2.6% in the first quarter of 2020 year on year. Growth was only recorded in non-residential building construction and civil engineering construction. Sharpest falls were recorded in machinery and equipment investments. Private investments are expected to contract by 7.6% in 2020. Growth will be at its slowest in the third quarter, but the sluggish growth will persist until the end of the year. Growth in private investments will remain slow in the coming years. On average, private investments will decrease by 1.1% during the forecast period, which means that their ratio to GDP will be just 19% at 2022.

There will be a slight decrease in housing construction in 2020 and a sharper fall will follow in 2021. The number of housing starts in the first half of 2020 was significantly above average and higher than in the same period in 2019. However, housing starts are expected to decline in the second half of the year and thus, it is forecast that housing construction investments will fall by 2.0% this year. There will probably also be postponements of housing starts. This means that housing starts will decline by several thousand by the year 2021, which will mean

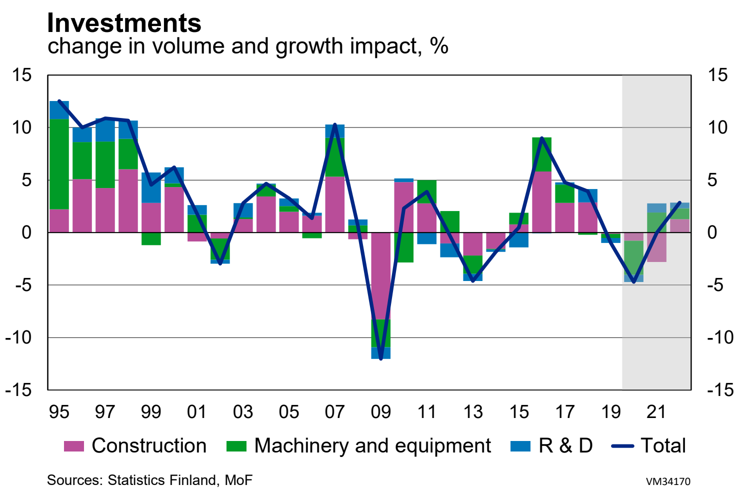


lower investments in housing construction in 2021. After that, housing starts will gradually approach the long-term average.

Non-residential building construction will decrease by 2% in 2020 and the downward trend will accelerate in 2021. The high number of starts in commercial construction and especially in the construction of public service buildings in the second half of 2019 will sustain non-residential building construction. Boosted by infrastructure investments, civil engineering construction will grow at the start of the outlook period and the growth will continue in 2021.

In an uncertain situation, there will be a substantial decline in investments in machinery and transport equipment in 2020 but they will pick up in 2021. Stronger demand both domestically and internationally towards the end of the outlook period will boost investments in machinery and equipment. The likelihood that major industrial projects will be launched will also increase towards the end of the outlook period. Research and development expenditure will fall at the start of the outlook period, but after that it will increase throughout the period. Government R&D funding will increase in 2020 and 2021.

The uncertain investment environment may prompt companies to postpone investments or cancel them altogether. At the same time, however, investments during the outlook period are supported by European initiatives to boost investments and the public investments during the early part of the period.



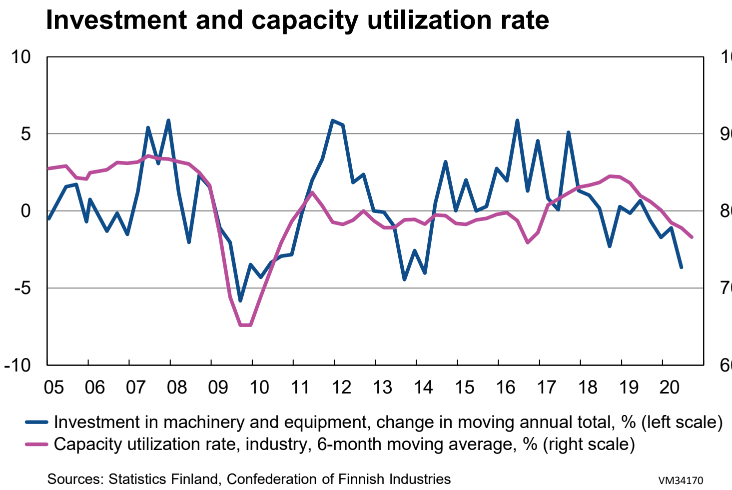


Table 9. Fixed investment by type of capital asset

	2019	2017	2018	2019	2020**	2021**	2022**
	share, %	change in volume, %					
Buildings	52.5	6.6	5.8	0.5	-2.0	-5.5	2.6
Residential buildings	30.2	5.1	4.5	-2.1	-2.0	-5.5	3.5
Non-residential buildings	22.3	8.8	7.8	4.1	-2.0	-5.5	1.5
Civil engineering construction	8.8	-3.1	0.1	-4.0	3.0	2.0	-1.0
Machinery and equipment	21.6	7.5	-0.8	-1.8	-15.0	10.0	5.0
R&D-investments[1]	17.2	1.1	7.2	-2.6	-4.0	5.0	3.0
Total	**100.0**	**4.8**	**3.9**	**-1.0**	**-4.7**	**-0.0**	**2.9**
Private	82.1	5.7	3.7	-1.5	-7.6	0.2	4.2
Public	17.9	0.5	5.0	1.3	8.7	-0.9	-2.6
		%					
Investment to GDP ratio (at current prices)							
Fixed investment		23.4	24.1	23.9	23.9	23.4	23.7
Private		19.3	19.9	19.6	19.1	18.7	19.2
Public		4.1	4.2	4.3	4.8	4.7	4.5

[1]Includes cultivated assets and intellectual property products

1.3.4 Public investment

Public investments account for almost 20% of all investments. Local government investments account for more than half of the total, while central government investments account for the rest. The proportion of social security funds is very small. Almost 30% of all public investments are civil engineering investments, and other building investments account for a same proportion of the total. Research and development investments account for just over 25% and machinery and equipment investments for just over 10% of the total.

Public investments have been in substantial scale in recent years. They have accounted for more than 4% of GDP and further growth is expected this year.

The stimulus measures introduced by Prime Minister Marin's Government and the measures set out in the Government Programme will significantly increase public investments this year. Central government investments in particular will be boosted by inputs in transport infrastructure projects as well as in research, development and innovation. Local government investments will also increase in 2020. The growth arises from health and social services construction and investments in local government infrastructure. There will be a slight decrease in public investments in 2021 and the downward trend will accelerate in 2022.

1.4 Domestic production

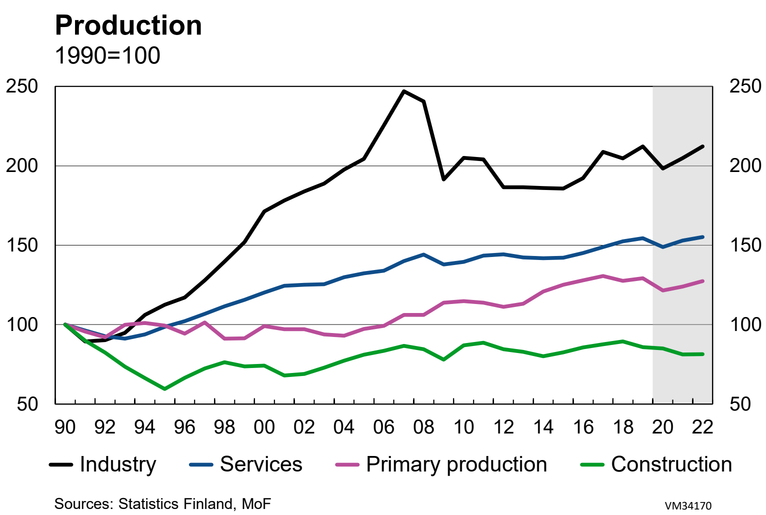
1.4.1 Total output

The Finnish economy will contract less than previously forecasted

Finland's gross domestic product contracted by 4.5% in the second quarter of 2020 from the previous quarter and by 6.4% year on year. However, value added (output) only contracted by 3.2% from the previous quarter and by 5.2% year on year.

Forest industry and chemical industry were hardest hit during the first half of the year. The downturn has not yet affected the metal industry. Not all service businesses have been affected in the same manner; hotels and restaurants have lost more customers than other operators in the sector. According to national accounts, public service production was at a lower level during the first half of 2020 than in the same period last year even though stimulus measures are expected to boost spending this year. Primary production also contracted whereas building construction grew throughout the first half of 2020.

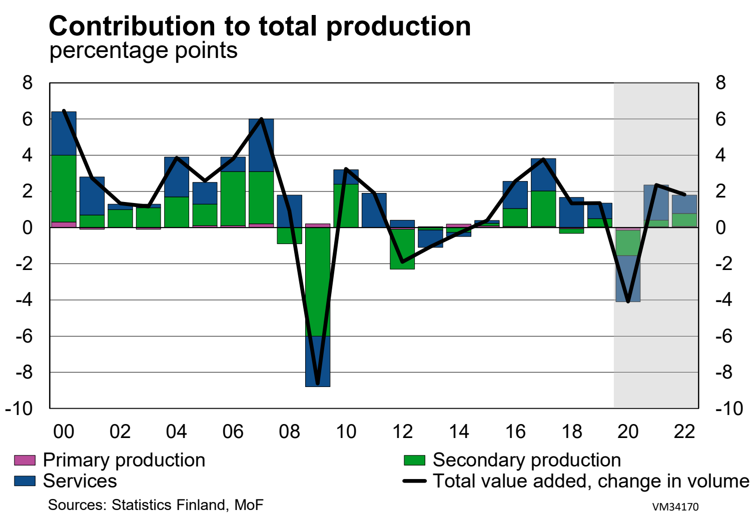
The first wave of the COVID-19 pandemic has hit Finland less hard than other countries. According to preliminary figures, in many countries, the GDP fell by about 10% (in some countries as much as 20%) during the second quarter of this year.



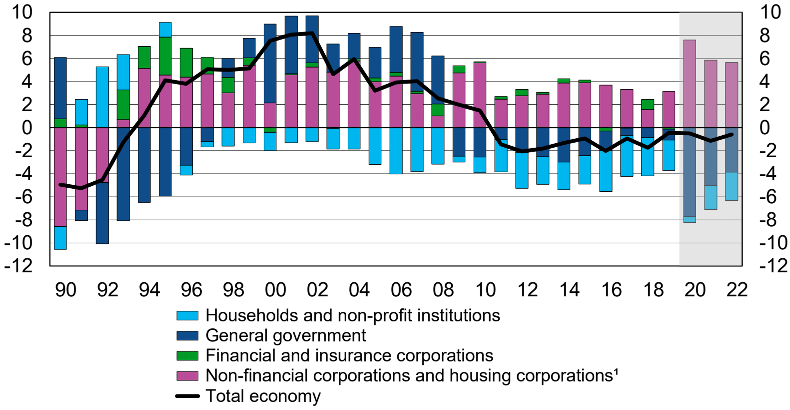
Based on their interim reports, large Finnish companies performed reasonably well during the second quarter. Industrial output has not been affected by the coronavirus situation as severely as feared. However, there was a steady decline in industrial orders during the first half of 2020 compared with the same period last year. International purchasing managers' indices suggest that the service sector growth is again slowing down because of an increase in coronavirus infections, while the figures for industrial companies are more encouraging.

Goods exports and exports of services in particular decreased in spring and the trend has probably continued during the summer months. It would seem that Finnish service sector companies that mainly operate in the domestic markets have been doing fairly well during the summer season. However, in August this year, only service sector companies were more optimistic about the future, while industrial and construction companies remained pessimistic. The demand for services may also decline again as people reduce their mobility voluntarily or as a result of temporary regional restrictions.

The forecast for 2020 has been revised upwards because the Finnish economy performed significantly better than expected in the first half of the year. Slight growth in output is already projected for the third quarter. Growth will come from services, as industrial production and construction will decrease. Driven by global economic recovery, growth will continue during the last quarter.



Net lending by sector
relative to GDP, %



1) Including financial sector in 2020-2022

Sources: Statistics Finland, MoF

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The Finnish GDP is forecast to decrease by 4.5% in 2020 but value added (output) is expected to fall less and be 4.1% lower than in 2019. In 2021, the GDP and value added are expected to grow by 2.6% and 2.4%, respectively, as services will recover more rapidly than industrial production. A COVID-19 vaccine is expected to be introduced in 2021, which will constitute a positive risk in the forecast. It may well be that when the infection risk disappears, people are more eager to spend and travel than what is assumed in this forecast. In 2021, economic growth will significantly exceed its potential because world trade will pick up. Other sectors of the Finnish economy will grow but construction will decrease as high production volumes will be gradually adjusted to long-term demand.

In 2022, economic growth is expected to slow down to 1.7% once the services have returned to the pre-crises levels and private consumption is also growing at a slower rate than in 2021. Less reliance can also be placed on world trade growth in 2022.

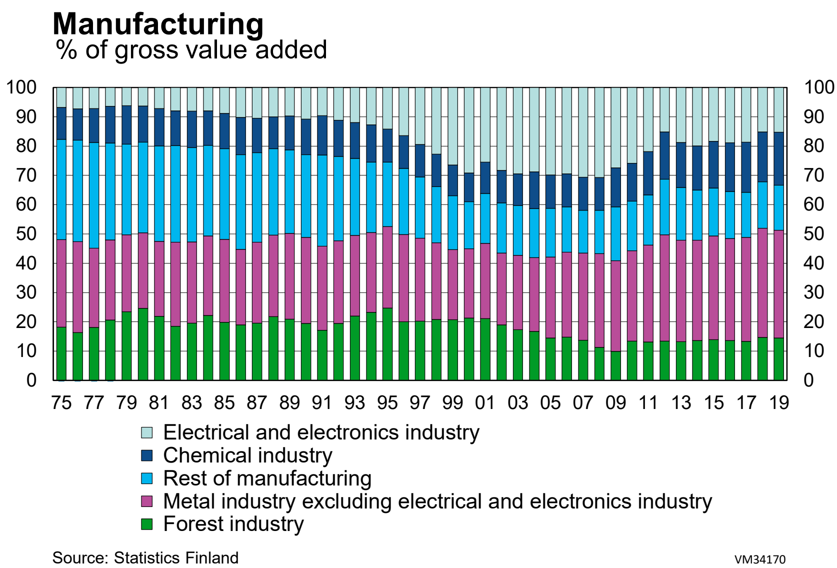
Economic productivity per hours worked will decrease by 0.6% this year because the value of production will decline more than the hours worked. Productivity per employed person will decrease by 2.5%. In 2021 and 2022, economic productivity per hours worked will increase at an annual rate of just over 1.5%. The operating surplus is expected to shrink this year by more than 8% but reasonable growth is already expected next year. Unit labour costs will increase by 0.5% in 2020, 2% in 2021 and by less than 1% in 2022.

1.4.2 Secondary production

Industrial output will fall sharply – growth is only expected next year

Industrial output has already contracted for three successive quarters, starting in the last quarter of 2019. It is forecast that the contraction will continue until the end of this year or for five successive quarters. The industrial production lost in 2020 is estimated at almost four billion euros. Output will decrease by 8% this year. Growth can only be expected at the start of next year as world trade and exports pick up. Brisk growth in industrial production is expected in 2021 and a growth of about 4% is forecast for the year. Quarter-to-quarter growth in industrial production in 2022 will remain moderate, even though annual growth will reach 4 per cent.

There are a number of reasons for the decline in industrial production this year and for the differences between sector-specific growth rates. Strikes were the main reason for the fall in forest industry output in the first quarter of this year (almost 20% from the previous quarter). The sector partially made up for the losses in the second quarter. The chemical industry has been hit particularly hard by the COVID-19 pandemic: in the second quarter of 2020, its output was about 8% lower year on year.



A decrease in orders and weak expectations have been given as reasons for the weak forecast for 2020. The trend in industrial orders was more than 10% lower during the first half of the year. However, the rate of decline has already slowed down slightly. Forest industry companies have posted the sharpest fall in orders, while the decrease has been smallest in the chemical industry.

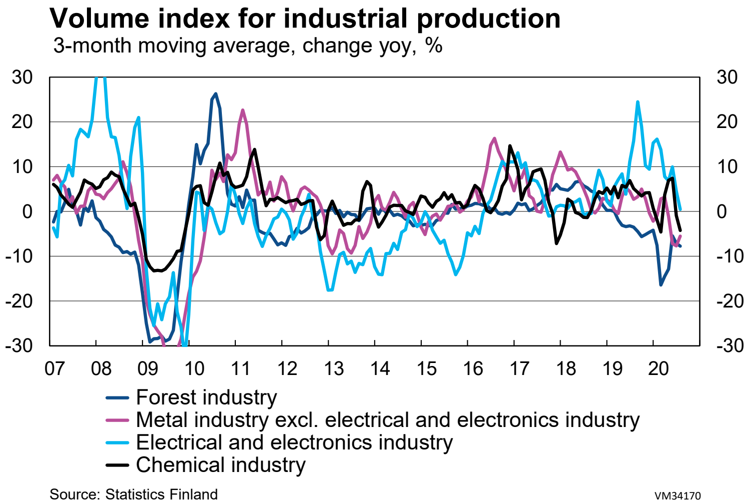
Expectations among industrial companies have improved since the spring months but the number of companies expecting a falling output is still significantly higher than the number of companies expecting the output to increase in the next six months. In the chemical industry, expectations are slightly higher than in other sectors.

Finnish industrial companies, especially metal industry companies, produce capital goods for both domestic use and for exports. The expectation is that extremely sluggish economic growth in global scale will substantially reduce the need for such products. For this reason, the recovery of Finnish industries may be weaker than projected.

In the forest industry, the demand for tissue papers and paperboard used as packaging material will probably increase as a result of the pandemic. Paper production is decreasing in Finland: one paper machine was closed at the end of last year, and two other machines will probably be closed before the end of this year. Furthermore, according to the latest information, probably additional paper machines will be closed by the end of the year. This will naturally impact production volumes in the coming years. The demand outlook for the wood industry remains bleak. This is because construction has decreased in the euro area and in many other markets for sawn timber, at least temporarily.

Sluggish demand for air transport and consequently for petroleum products during the current year is weakening the demand for chemical industry products. The estimate is that it will take several years for air traffic to return to pre-crisis levels.

The situation in the electrical and electronics industries is better than in other industrial sectors. According to a survey conducted by the Technology Industries Finland, about 90% of the companies in the sector have no plans to reduce workforce. At the same time, between 65% and 70% of companies in the machinery and metal products industries and metal processing plan to keep their workforce at current levels.

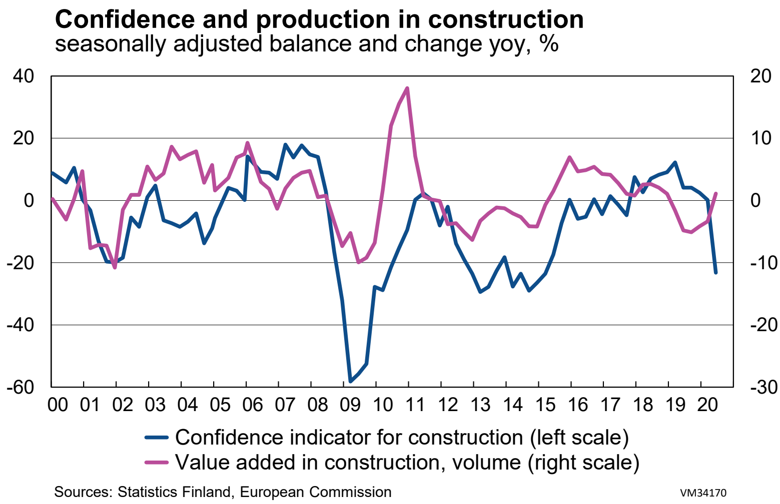


No decrease in construction until next year

Contrary to expectations, there was a slight increase in construction during the first half of the year. In fact, the growth can even be characterised as brisk: in the second quarter, output grew by 2% year on year. There were more housing starts year on year as the demand for new homes has remained strong. Interest rates have remained low, and as a result, the Finnish property market may also attract investors in the future. The volume of construction is expected to remain close to last year's levels this year.

There will be a substantial fall in construction in 2021 because the number of new building permits have decreased sharply in the first half of this year. There will be a particularly sharp reduction in the starts of public service buildings, which is natural after a long period of exceptionally rapid growth. Construction will pick up in 2022.

So far, the COVID-19 pandemic has only affected renovation construction, which has seen postponements of projects. However, there may be a sharp slowdown in construction during the last months of 2020 as companies in the sector are pessimistic about the autumn and winter months. The decline in the demand for housing may accelerate if the employment situation weakens more rapidly than anticipated. In a situation characterised by uncertainty, the construction sector may also become less willing to start new projects.



The number of housing starts this year is estimated at about 34,000, which would be about 4,000 fewer than in 2019. Measures have also been taken to stimulate housing construction this year. The number of housing starts is expected to fall to about 30,000 in 2021 and to increase to 32,000 in 2022. This year, activities in the sector will also be sustained by the construction of commercial buildings as a large number of projects have been launched this spring and it will take almost 1.5 years to complete them. The number of building starts will be substantially lower next year and the uncertain economic outlook in particular may prompt companies to postpone planned projects.

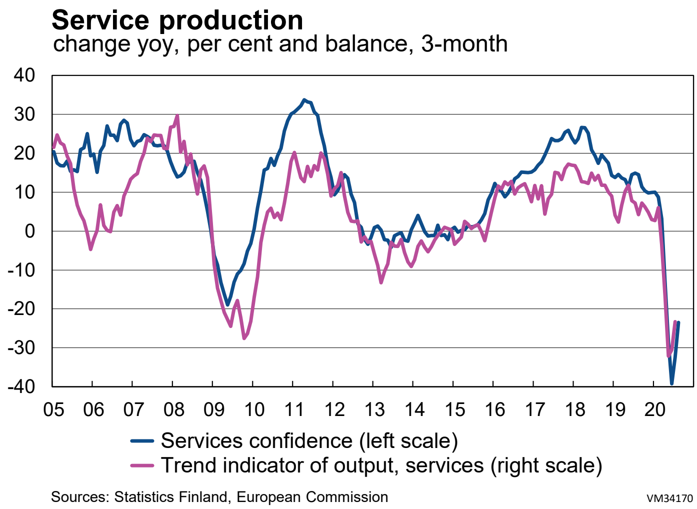
Further growth in renovation construction is expected and the COVID-19 pandemic has both increased and decreased renovation activities. Renovation projects have been started in premises that have been left nearly empty as employees have changed to remote work. At the same time, however, many housing companies postponed renovation projects in spring. An increase in the number of projects will speed up renovation construction in 2021. There has been a substantial increase in independent construction and renovation during the spring and summer months.

Stimulus projects will give a significant boost to civil engineering construction and the growth is already reflected in nearly two-digit increases in the turnover of civil engineering companies.

1.4.3 Services

Services will pick up in the second half of the year

A sharp reduction in service exports and a decrease in the demand for household services caused service production to decrease in the first and particularly in the second quarter. Private services decreased by 6% in the second quarter of 2020 from the previous quarter and almost 8% year on year. According to national accounts, there has not yet been any growth in public services but boosted by stimulus measures, public consumption and service production will grow significantly this year.



Services account for most (almost 70%) of Finland's total output and even though the decrease in industrial production is larger in percentage terms, contraction of services will have the greatest impact on GDP. There was a particularly sharp fall in transport services in the first half of the year, but business services also contracted by more than 5% in the second quarter compared with the first quarter. With the exception of property services, all service sectors contracted in the second quarter. There was a sharp fall in accommodation and catering services from the end of the first quarter as a result of the measures taken to contain the pandemic. The situation improved in June as the restrictions expired or were relaxed.

The forecast for this year's service output has also been revised upwards as a result of the statistics that give a better picture of the situation that the forecasts presented earlier this year. The outlook for services and for retail trade in particular have improved significantly since the spring months. According to the business tendency survey, service sectors expect sales to increase in the third and fourth quarters of this year. In the confidence indicator, too, all subindices are now pointing upwards. In the chart, the cyclical situation in the service sectors is examined by means of a three-month rolling average, which means that the weak months preceding the period assume more weight in the estimate. Turnover and sales in the service sector picked up in June.

Service production is expected to shrink by 3.6% this year. If the pandemic becomes worse, the challenges facing the tourism sector may reduce the demand for and supply of its services in the second half of the year more than anticipated. Most of the service sectors are expected to grow briskly next year even though in some areas (such as air traffic), the demand may remain at lower levels than previously for many years. Services are expected to grow by almost three per cent next year.

Table 10. Production by industry

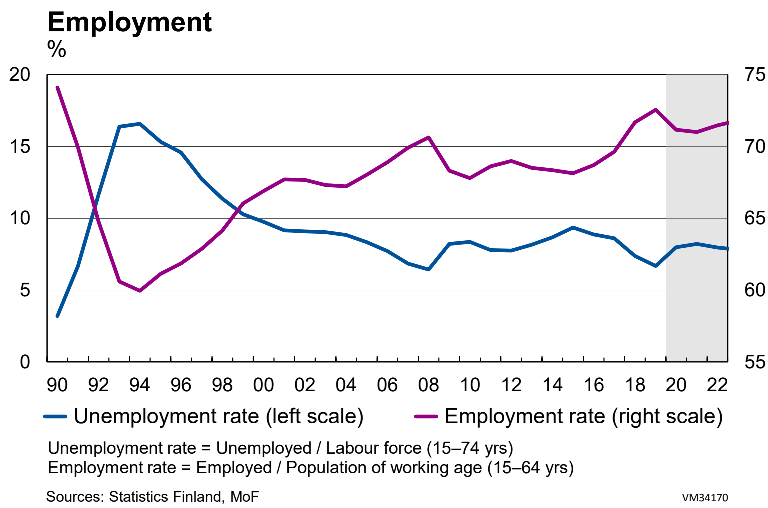
	2019	2017	2018	2019	2020**	2021**	2022**
	share, %[1]	change in volume, %					
Industry	20.5	8.6	-2.0	3.7	-6.8	3.4	3.6
Construction	7.5	2.2	2.1	-3.9	-0.5	-4.5	0.3
Agriculture and forestry	2.7	2.1	-2.3	1.2	-5.9	2.0	2.7
Industry and construction	28.0	7.0	-0.9	1.6	-5.2	1.3	2.6
Services	69.4	2.6	2.4	1.2	-3.6	2.7	1.4
Total production at basic prices	100.0	3.8	1.3	1.3	-4.1	2.4	1.8
GDP at market prices		3.3	1.5	1.1	-4.5	2.6	1.7
Labour productivity in the whole economy		3.0	-1.0	0.2	-0.6	1.8	1.5

1) Share of total value added at current prices.

1.5 Labour force

Unemployment is on the rise

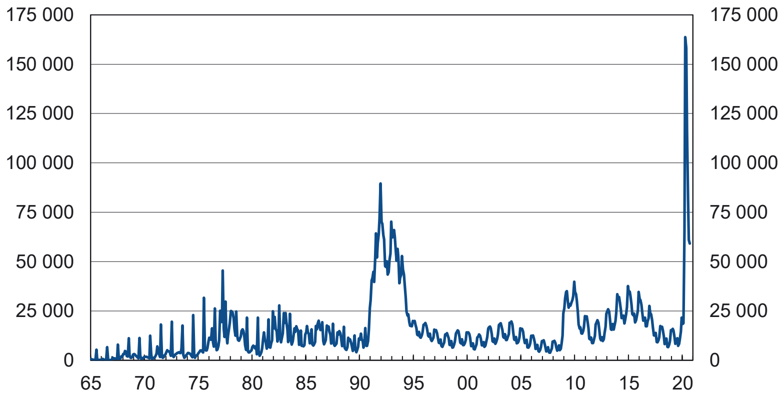
There was a substantial decrease in the employment rate in the first half of the year. Trend of employment rate stood at 71.9% in July, which was more than one percentage point lower than in January. In the period January-July, the number of employed persons was 35,000 lower than a year ago and the rate of decline accelerated during the summer months. In the first half of the year, the number of full-time employees was still higher than in 2019 but the number of part-time workers was significantly lower year on year. There was also a sharp increase in the number of underemployed persons. The number of hours worked decreased by 2.8% or twice as much as the number of employed persons. The fall in employment was sharpest in retail trade and in accommodation and catering. Employment increased in energy services and in a number of business services.



At the moment, there is no demand for labour force in the labour market because the number of persons outside the labour force increased in the first half of the year. Hidden unemployment in particular is higher than in 2019. Demand for labour has been on the decrease since the early months of the year. In June, job vacancies totalled 35,400, which was substantially less than in the same period last year. In fact, the employment expectations of Finnish companies collapsed in April (especially in services). By August, companies had become more optimistic, but they still expect lower employment rates in the main sectors.

Companies have adjusted their labour costs by laying off staff and making employees redundant. Layoffs peaked at the end of April when more than 160,000 persons were laid-off at a full-time basis. This figure was almost twice as high as the previous peak (in 1991). The number of laid-off employees has decreased rapidly since then but at the end of August, there were still more than 60,000 persons that were laid-off on a full-time basis. There will be hundreds of thousands of people registered as jobseekers for many months to come because the number of persons registered as unemployed for other reasons by the Ministry of Economic Affairs and Employment totalled 266,000 at the end of August. At the same time, the number of unemployed jobseekers totalled about 329,000.

Number of full-time layoffs
persons at the end of the month



Source: MEAE

The number of employed persons will decrease more sharply this year as the measures to contain the COVID-19 pandemic and the slow recovery from coronavirus will cause total output and the demand for labour to fall. If the recovery from the downturn will continue as expected during the second half of the year, the employment rate will fall considerably more slowly after the turn of the year. In that case, employment will decrease by an average of 2% this year and the employment rate will decrease to about 71%.

If the crisis is largely over by the end of this year, predicted economic recovery will gradually improve demand for labour in 2021 and 2022. Due to the weak first half of the year, the number of employed persons would decrease slightly in 2021 and would start growing again in 2022. The number of employed persons would nevertheless remain substantially below 2019 levels and the employment rate would stand at 71.5% in 2022.

The internationally comparable number of unemployed registered by Statistics Finland has increased considerably less than the number of unemployed jobseekers registered by the Ministry of Economic Affairs and Employment.[1] However, according to the labour force survey of Statistics Finland, there has also been a sharp increase in the number of hidden unemployed who are outside the labour force but interested in work and the number of underemployed individuals willing to work longer hours. The figures collected by the Ministry of Economic Affairs and Employment also show that there has been an increase in both cyclical and structural unemployment in all groups except those moving from one employment service to another.

In the future, unemployment will increase more rapidly than during the first half of 2020 as the demand for labour remains low, the downturn will prompt companies to make more employees redundant and many of the laid-off employees will not be able to return to working life. As a result of the falling employment rate and because of a large number of layoffs, the number of unemployed will increase by about a fifth in 2020 and the unemployment rate will reach 8%. Even if the recovery from the COVID-19 pandemic continued and the economic downturn did not lead to a wave of bankruptcies and mass redundancies, unemployment would still increase next year. In the modest economic recovery scenario, unemployment would reach 8.2% next year and, driven by economic growth, would only fall in 2022.

Table 11. **Labour market**

	2017	2018	2019	2020**	2021**	2022**
	annual average, 1,000 persons					
Population of working age (15–74 yrs)	4114	4124	4128	4131	4123	4111
change	5	10	4	3	-8	-12
Population of working age (15–64 yrs)	3451	3439	3428	3423	3416	3410
change	-12	-12	-11	-5	-7	-6
Employed (15–74 yrs)	2474	2538	2567	2514	2502	2514
of which 15–64 yrs	2403	2465	2487	2436	2425	2437
Unemployed (15–74 yrs)	233	202	184	218	224	218
	%					
Employment rate (15–64 yrs)	69.6	71.7	72.5	71.2	71.0	71.5
Unemployment rate (15–74 yrs)	8.6	7.4	6.7	8.0	8.2	8.0
	1,000 persons per annum					
Immigration, net	17	16	18	16	16	16

1 In the labour force survey of Statistics Finland, laid-off employees are entered as persons outside the labour force (about 1/2), employed persons (about 1/3) and as unemployed (only about 1/6).

1.6 Incomes, costs and prices

1.6.1 Wages and salaries

Earnings will rise but rising unemployment will reduce the wage bill

The rate of nominal wage increases slowed down from 2.1% last year to 1.6% in the early months of the year. The slowdown was due to lower negotiated pay rises because wage drifts increased. Partially as a result of the reinstatement of the holiday bonuses after summer 2019, public sector earnings rose at a slightly faster rate than earnings in the private sector.

A large number of new collective agreements have been concluded in the private and public sector this year. There are few collective agreements in the private and public sector that will expire this year[1]. The collective agreements of food industry employees, deck officers employed in international maritime traffic, air traffic controllers and salaried employees in road transport will expire in spring 2021. Under the agreements, average nominal wages will rise by almost 1.5% this year. Despite the economic downturn, wage drifts seem to be higher than in 2019, which means that nominal earnings will increase by about 1.75%.

Higher level of economic activity and the resulting rise in employment will probably lead to higher wage drifts from next year. Moreover, the private and public sector wage rises agreed for 2021 are about 0.5 percentage points higher than this year. Thus, the negotiated increases and nominal increases would amount to 2.5% next year. Some of the collective agreements concluded this year will remain in effect until early 2023. The wage rises for the employees covered by these agreements will be set at a later date but the assumption in the forecast is that the negotiated increases will not be higher than in 2021. Thus, nominal wages would rise by 2% in 2022.

In addition to nominal earnings, the wage bill is also affected by employment trends. As the employment will fall sharply this year, the wage bill will also decrease (by two per cent). Driven by rising earnings and higher employment, the wage bill is expected to increase by just over 2.5% in 2021 and 2022.

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1 The collective agreement for tourism and restaurant sector employees was extended in March and it will expire on 30 September 2020.

Table 12. Index of wage and salary earnings and labour costs per unit of output

	2017	2018	2019	2020**	2021**	2022**
	change, %					
Index of negotiated wage rates	-0.3	1.2	2.0	1.2	2.0	1.4
Wage drift, etc.	0.5	0.5	0.1	0.5	0.5	0.6
Index of wage and salary earnings	**0.2**	**1.7**	**2.1**	**1.7**	**2.5**	**2.0**
Real earnings[1]	-0.5	0.6	1.1	1.3	1.3	0.6
Average earnings[2]	0.7	2.2	1.8	1.6	2.4	2.1
Labour costs per unit of output whole economy[3]	-2.9	2.5	1.6	0.5	1.9	1.0

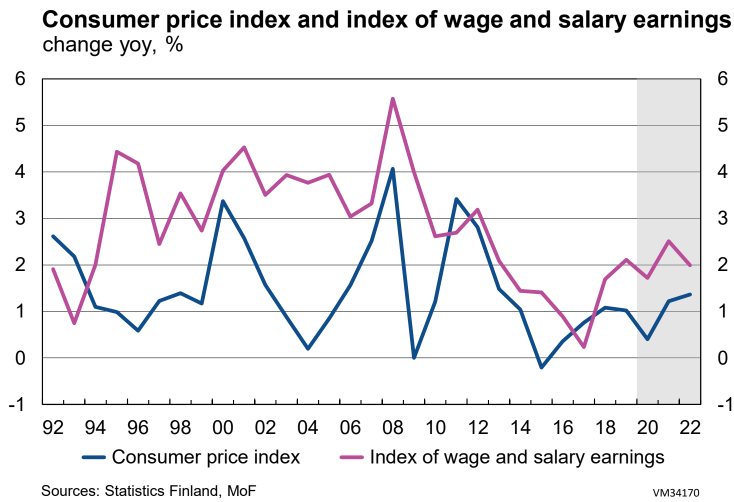
1) The index of wage and salary earnings divided by the consumer price index.
2) Computed by dividing the national wage bill by the number of hours worked by wage and salary earners. The figures are affected by structural changes in the economy.
3) Compensation of employees divided by gross value added in volume at basic prices.

1.6.2 Consumer prices

After a three-month deflation, the annual change in the consumer price index was positive in July. There was a sharp increase in food prices (especially fresh foods) in the first half of the year and the upward trend is accelerating. The fall in the prices of goods has also stopped, at least momentarily. The decline in energy prices is causing a substantial fall in consumer prices but the impact is already less marked than during the sharpest decrease in April.

Measured with the national consumer price index, an inflation rate of 0.4% is forecast for 2020. The fall in oil prices will reduce the price of energy despite the tax increases introduced in August, which will slow down the downward trend during the last months of the year. The rise in food prices is the biggest single inflationary factor this year.

Contraction of demand this year and uncertainty about the future will keep the inflation rate at moderate levels throughout the outlook period. The national consumer price index is expected to rise by 1.2% in 2021 and by 1.4% in 2022. Tax increases targeting consumption will boost inflation in both years, particularly in 2021.



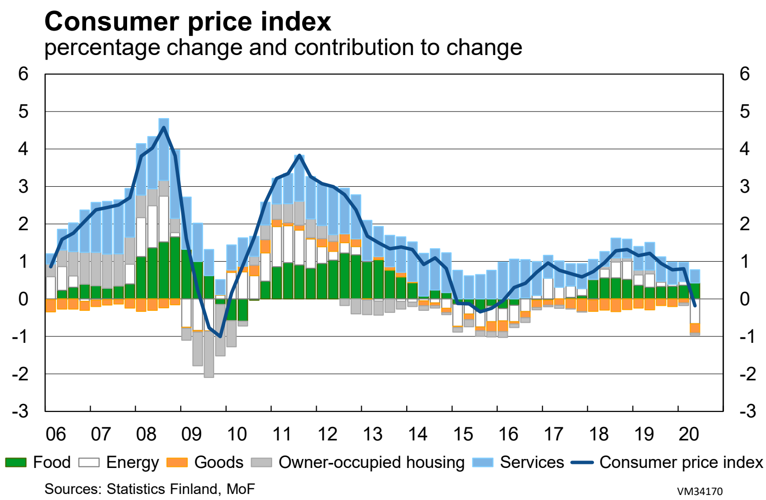


Table 13. Price indices

	2017	2018	2019	2020**	2021**	2022**
	change, %					
Export prices[1]	3.4	4.2	-0.3	-4.5	1.3	1.5
Import prices[1]	3.8	3.4	0.4	-4.9	1.4	1.6
Consumer price index	0.7	1.1	1.0	0.4	1.2	1.4
Harmonised index of consumer prices	0.8	1.2	1.1	0.6	1.3	1.5
Basic price index for domestic supply, including taxes	4.9	4.7	1.0	-3.7	1.2	2.0
Building cost index	0.3	2.2	1.0	0.5	1.8	1.9

[1] As calculated in the National Accounts

2 Public finances

2.1 General government finances

The economic downturn triggered by the coronavirus pandemic and the measures to contain its impacts will substantially increase Finland's general government deficit this year. The deficit is estimated to be about EUR 18 billion.

General government finances will not return to the pre-pandemic levels when the downturn is over. The economic growth expected in the coming years will not be enough to balance the general government budgetary position and Finland's general government finances will remain substantially in deficit. The substantial deficits accumulated by central and local government will also increase the debt ratio in the coming years.

The structural factors weakening the sustainability of general government finances have not disappeared but will have a permanent impact irrespective of economic cycles. Ageing of the population has already increased pension expenditure as well as care and treatment costs and this trend will continue in the coming decades. The sustainability gap in general government finances remains unsolved.

Most of the funding for the support measures prompted by the coronavirus epidemic comes from central government. The fiscal policy is strongly expansionary this year. Finland's fiscal stance is described in more detail in the box on page 65. Central government deficit will shrink from the next year onwards as the economy starts growing and most of the support measures will come to an end.

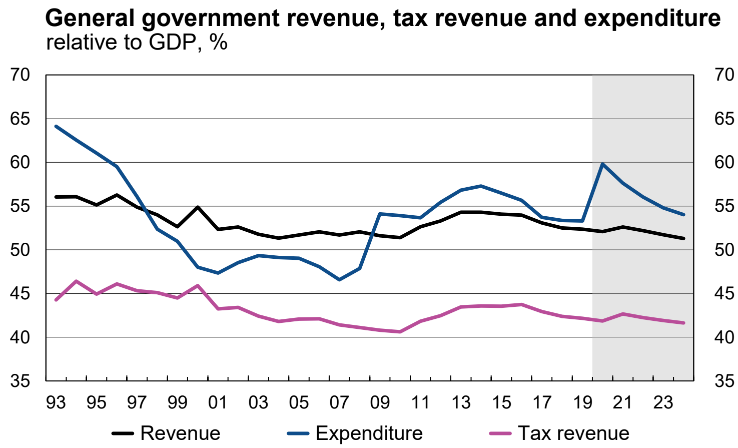
The situation in local government will remain difficult. The local government budgetary position is burdened by the growing need for health and social services and expenditure as the population is ageing. The current economic downturn means lower tax revenue, but the pandemic has also prompted central government to provide municipalities with substantial financial support.

The surpluses accumulated by employment pension institutions will be wiped out almost completely in 2020 as the employment pension contribution is temporarily lowered and the rising unemployment is reducing contribution income. Surpluses of the employment pension institutions will also remain around 0.5% in the coming years as pension expenditure continues to grow and low interest rates slow down growth in the institutions' property income.

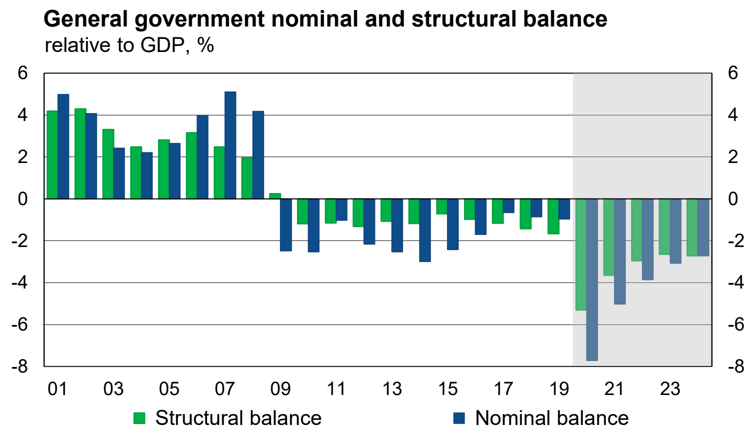
The financial position of the other social security funds is weakened by large-scale layoffs, rising unemployment and the temporary extension of the unemployment security. Decrease in the number of layoffs and the increase in the unemployment insurance contribution will ease the situation of other social security funds next year.

The general government debt-to-GDP ratio is now rising rapidly: this year it will increase over ten percentage points, to about 70%. The sudden rise in the debt ratio is caused by the contraction of GDP and especially by a huge increase in central government deficit. The debt ratio will be over 75 % by the year 2024.

The most important risks now facing general government finances are closely connected with overall economic developments. It now seems that the Finnish economy will start recovering at the end of this year. At the same time, however, a second wave of the pandemic, growing uncertainty and the reintroduction of extensive restrictions would slow down the economic recovery and weaken general government finances. Moreover, general government contingent liabilities and especially the rapid rise in guarantees will pose a risk for general government finances. Concentration of the guarantee liabilities in a small number of sectors and companies is increasing the risks arising from the liabilities. Guarantee authorisations will also increase this year as part of the measures introduced to support companies. Extensive realisation of the liabilities would lead to higher public spending and speed up the increase in the debt-to-GDP ratio.



Sources: Statistics Finland, MoF VM34098



Based on the European Commission's production function approach

Sources: Statistics Finland, MoF VM34098

Table 14. General government finance[1)]

	2017	2018	2019	2020**	2021**	2022**
	EUR billion					
Current taxes	37.2	37.4	38.4	36.9	38.9	40.1
Taxes on production and imports	31.6	33.1	33.7	32.5	34.0	34.5
Social security contributions	27.3	27.9	28.6	27.2	29.6	30.3
Taxes and contributions, total[2]	97.0	99.1	101.4	97.4	103.3	105.8
Other revenue[3]	23.8	24.3	25.3	24.6	24.9	25.7
of which interest receipts	1.7	1.7	1.6	1.5	1.5	1.7
Total revenue	**119.9**	**122.7**	**125.9**	**121.1**	**127.4**	**130.6**
Consumption expenditure	51.6	53.4	55.3	59.3	61.1	61.7
Subsidies	2.7	2.7	2.9	5.3	3.3	2.9
Social security benefits and allowances	42.6	43.0	43.8	47.3	47.3	48.3
Other current transfers	5.3	5.6	6.0	6.3	6.7	6.3
Subsidies and current transfers, total	50.6	51.4	52.6	58.9	57.3	57.6
Capital expenditure[4]	9.6	10.2	10.7	11.8	12.0	11.8
Other expenditure	9.6	9.7	9.6	9.1	9.2	9.2
of which interest expenses	2.3	2.1	1.9	1.7	1.6	1.5
Total expenditure	**121.4**	**124.7**	**128.2**	**139.1**	**139.6**	**140.3**
Net lending (+) / net borrowing (-)	**-1.5**	**-2.0**	**-2.3**	**-18.0**	**-12.2**	**-9.7**
Central government	-4.0	-2.9	-2.9	-16.8	-10.6	-7.9
Local government	-0.5	-2.0	-2.7	-1.0	-2.4	-2.8
Employment pension schemes	2.4	2.3	2.7	0.3	0.9	1.2
Other social security funds	0.7	0.6	0.6	-0.5	-0.2	-0.1
Primary balance[5]	-0.9	-1.6	-2.0	-17.8	-12.1	-9.8

1) As calculated in the National Accounts
2) Incl. capital taxes
3) Incl. capital transfers and consumption of fixed capital
4) Gross fixed capital formation and capital transfers
5) Net lending before net interest expenses

Table 15. Main economic indicators in general government

	2017	2018	2019	2020**	2021**	2022**
	relative to GDP, %					
Taxes and social security contributions	42.9	42.4	42.2	41.9	42.7	42.3
General government expenditure[1]	53.7	53.4	53.3	59.8	57.6	56.0
Net lending	-0.7	-0.9	-1.0	-7.7	-5.0	-3.9
Central government	-1.8	-1.2	-1.2	-7.2	-4.4	-3.2
Local government	-0.2	-0.9	-1.1	-0.4	-1.0	-1.1
Employment pension institutions	1.0	1.0	1.1	0.1	0.4	0.5
Other social security funds	0.3	0.2	0.3	-0.2	-0.1	-0.1
Primary balance[2]	-0.4	-0.7	-0.8	-7.7	-5.0	-3.9
General government debt	61.3	59.6	59.2	70.2	72.8	74.3
Central government debt	46.8	44.9	44.2	53.3	55.6	56.6
General government employment, 1,000 persons	619	632	647	662	662	662
Central government	132	135	136	138	138	138
Local government	476	484	497	511	511	511
Social security funds	12	13	13	13	13	13

1) EU-harmonized definition
2) Net lending before net intrest expenses

Table 16. Fiscal balance and debt ratios in some EU economies

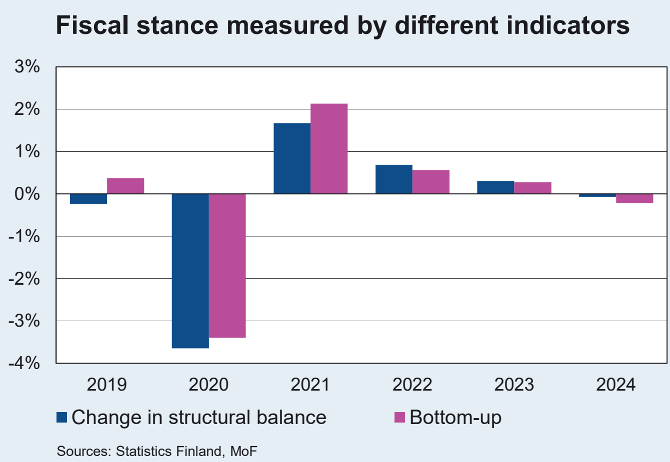
	2018	2019	2020**	2018	2019	2020**
	Fiscal balance			Debt		
	relative to GDP, %					
*Finland	-0.9	-1.0	-7.7	59.6	59.2	70.2
Finland	-0.9	-1.1	-7.4	59.6	59.4	69.5
United Kingdom	-2.2	-2.1	-10.5	85.7	85.4	102.1
Sweden	0.8	0.5	-5.6	38.8	35.1	42.6
Denmark	0.7	3.7	-7.2	34.0	33.2	44.7
Ireland	0.1	0.4	-5.6	63.5	58.8	66.4
Spain	-2.5	-2.8	-10.1	97.6	95.5	115.6
The Neatherlands	1.4	1.7	-6.3	52.4	48.6	62.1
Luxembourg	3.1	2.2	-4.8	21.0	22.1	26.4
Portugal	-0.4	0.2	-6.5	122.0	117.8	131.6
Austria	0.2	0.7	-6.2	74.0	70.4	78.8
Germany	1.9	1.5	-7.0	61.9	59.8	75.7
France	-2.3	-3.0	-9.9	98.1	98.1	116.5
Belgium	-0.8	-1.9	-8.9	99.8	98.6	113.9
Italy	-2.2	-1.6	-11.1	134.8	134.8	158.9
Greece	1.0	1.5	-6.4	181.2	176.6	196.4

Sources: EU Commission Spring Forecast 2020; *Finland: Ministry of Finance, Autumn 2020

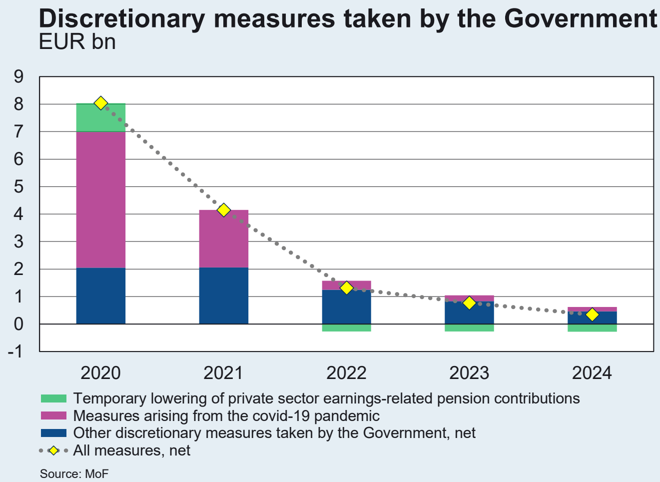
FISCAL STANCE

Fiscal stance is usually examined as the year-on-year change in the cyclically adjusted general government budgetary position or in the scale of the measures impacting general government finances. Chart 1 presents general government fiscal stance from two perspectives[1]. When examined from this basis, fiscal policy will be strongly expansionary in 2020 and contractionary in 2021. Fiscal policy will be tightened in 2021 as many of the one-off measures to stimulate the economy and to deal with the COVID-19 pandemic are coming to an end. It is estimated that Finland's fiscal policy will be neutral in the medium term. In addition to the discretionary measures taken by the Government of Prime Minister Marin, all changes in social security contributions are also taken into account in Chart 1.

Chart 2 shows the cumulative impact of the decisions by Prime Minister Marin's Government and the lowering of the employment pension contribution (introduced as a temporary support measure) on net lending recognised in the national accounts. These measures will weaken net lending by more than EUR 8 billion in 2020 and by EUR 4 billion in 2021. In addition to the measures introduced this year, the measures set out in the Government Programme are also strongly expansionary. The combined impact of the measures will be weaker in 2021 as many of the one-off measures for 2020 introduced to deal with the downturn and the exceptional situation will expire.



1 The matter can also be examined using the top-down approach, in which the fiscal stance is examined on the basis of the structural balance. The second option is to use the bottom-up approach, in which individual measures are combined to get an overall picture of the situation. Different approaches may produce different results and there are uncertainties with both indicators.



The funds channelled from the EU recovery instrument will stimulate the economy in the next few years but the plans and decisions on allocating the funds will only be taken later (see box on page X). The future-oriented investment programme set out in the Government Programme also contains provisions for 2021 and 2022 and the final decisions on their use have not yet been made[2]. The next year's fiscal stance will also be affected by municipalities' budgets for 2021 and the decisions impacting their revenue and expenditure. These factors, the impact of which is not yet known, have not been taken into account in the fiscal forecast or in the figures presented in this box.

Not all on-budget stimulus measures impact the net lending recognised in the national accounts and are therefore not shown in Charts 1 or 2. Financial investments and borrowing authorisations are the most significant differences in this respect.

2 In its negotiations on the 2021 Budget proposal, the Government decided to reallocate some of the provisions made for the future-oriented investments. The Government will allocate EUR 0.7 billion of the remaining 2021 and 2022 provision of EUR 1.7 billion to expenditure set out in the Government Programme and there will also be new allocations totalling EUR 0.9 billion to cover spending limits expenditure. The new allocations will be partially channelled to deal with the harmful impacts of the coronavirus pandemic.

IMPACT OF THE MEASURES PROMPTED BY THE CORONAVIRUS SITUATION ON GENERAL GOVERNMENT REVENUE AND EXPENDITURE

The Government has presented five supplementary budgets to Parliament by mid-September 2020. Most of the measures contained in the supplementary budgets are intended to deal with the COVID-19 pandemic. The 2021 Budget proposal also contains spending increases and support measures prompted by the pandemic.

The COVID-19 measures set out in the five 2020 supplementary budgets and the 2021 Budget proposal are shown in the table below. The table shows on-budget appropriations. The measures are described in more detail in the economic surveys for spring and summer 2020. Some of the figures in the fiscal forecast differ from the budgeted appropriations or their timing (for example, if the follow-up data shows that not all appropriations are spent during the budget year). The minutes of the negotiations on the 2021 Budget proposal, in which the Government has unequivocally committed itself to future appropriations, are also taken into account in the forecast.

In its 2021 Budget proposal, the Government is preparing for COVID-19 testing by allocating more than EUR 1.4 billion for the purpose. According to the minutes of the budget negotiations, the Government has also pledged to spend about EUR 0.4 billion on testing in 2020. As the final proposal for the higher testing appropriations in 2020 will only be presented to Parliament later in the autumn as part of a supplementary budget proposal, the increase is not shown in the table below. The Government has made a policy decision that if any of the testing appropriations remain unused, the difference will not be allocated to other expenditure.

The 2021 Budget proposal also includes a support package for local government finances, which will weaken central government net lending but will boost local government net lending by the same amount. Extending the increase in corporate tax apportionment for municipalities will increase local government tax revenue by EUR 510 million in 2021 and by EUR 40 million in 2022 and will reduce central government tax revenue by the same amount. Central government transfers to municipal basic services were also increased by EUR 300 million on a one-off basis to compensate for the fall in local government tax revenue as a result of the coronavirus situation. Hospital districts and municipalities were also granted EUR 200 million in government aid for costs arising from the pandemic.

According to the minutes of the budget negotiations, the Government has also pledged to augment the package to support local government finances in 2020 introduced earlier in the year by increasing the central government transfers for basic services by EUR 400 million, and by granting hospital districts and municipalities EUR 200 million in additional government aid. These increases are on a one-off basis and they will be included in a 2020 supplementary budget that will be presented to Parliament later in the autumn[1].

The exact timing of the all these measures cannot be estimated on the basis of on-budget annual appropriations. For example, investment projects are deferrable appropriations extending over several years, which means that the appropriations budgeted for this year can also be used in the coming years. Some of the projects may continue in 2021 or be postponed to next year, and in that case, they will not have any immediate stimulus impact. For this reason, funding for basic transport infrastructure management and the development of the transport infrastructure will also have impacts beyond 2020.

The timing of most of the spending budgeted for this year still remains unclear. However, the application period for some of the aid schemes has already ended and there is thus information available about their use. For example, the application periods for Business Finland grants and funding provided by ELY Centres ended in early June. A total of EUR 980 million was appropriated for Business Finland grants and so far, more than EUR 900 million has been distributed. Appropriations totalling EUR 400 million have been allocated to the funding scheme managed by ELY Centres, and so far, decisions have made on grants amounting to about EUR 300 million. Some the applications for funding granted under these two schemes are still outstanding.

In some of the schemes, the amounts granted as benefits and aid have been lower than anticipated. The Government had budgeted more than EUR 90 million in temporary epidemic support for parents of small children and individuals coming from abroad but in the end, only about EUR 2 million was actually granted. Likewise, it seems that just over EUR 100 million of the general cost support for companies will be used. In the fifth supplementary budget for the year 2020, the appropriation allocated for the general cost support was reduced from EUR 300 million to EUR 270 million.

1 According to the minutes of its budget negotiations, the Government has also pledged to reduce the treatment and service backlog by EUR 450 million between 2021 and 2023, and reimburse municipalities for the direct coronavirus costs as long as the epidemiological situation and the implementation of the hybrid strategy so require. The reduction of the treatment and service backlog is not considered in the forecasts as the measures have not yet been finalised.

Table 1. Measures prompted by the coronavirus situation that will impact general government net lending, EUR billion

	2020	2021	2022
Support for enterprises: grants provided for companies by Business Finland and ELY Centres, support for solvency of sole entrepreneurs, support for catering entrepreneurs, support for agricultural and natural resource economy enterprises, general cost support for companies, estimated increase in Finnvera's loss compensation	2.0	0.4	0.2
Extension of unemployment security: eliminating the waiting period, speeding up the layoff procedure, making entrepreneurs eligible for unemployment security, extending the payment period of startup grants, streamlining unemployment benefit payments, epidemic compensation	0.5	0.0	
Extension of social benefits: support for individuals arriving from other countries and parents of small children, temporary increase in social assistance	0.2	0.0	
Children and young people, and wellbeing of the elderly: free leisure activities, early childhood education and care, basic education and general upper secondary education, guidance counselling and youth work, student health care, ensuring properly functioning services for the elderly	0.3		
Investment projects: basic transport infrastructure maintenance, developing the transport network, renovation construction, and public transport support. The sum for the year 2022 is based on a technical assumption concerning the timing of the projects.	0.3	0.1	0.1
R&D&I, competence and wellbeing: additional starting places for higher education and developing continuous learning, research appropriations for the Academy of Finland, public employment and business services and developing the service structure.	0.3	0.1	0.0
Health and social services resources and equipment purchases, and covid-19 research	0.8	1.5	0.0
Other expenditure increases arising from the coronavirus situation	0.5	0.0	0.0
Expenditure increases total	**4.9**	**2.1**	**0.3**
Lowering of private-sector pension contributions for the period 1 May - 31 December 2020. Funding will come from the EMU buffer fund of the employment pension scheme. The buffer fund will be augmented again by raising the pension contributions for the period 2022-2025.	-1.1	0.0	0.3
All measures impacting revenue	**-1.1**	**0.0**	**0.3**
Total impact on net lending	**-6.0**	**-2.1**	**-0.1**

*The budgeted impacts of the measures are listed in the Table.

As part of the measures to support companies and citizens, tax payment arrangements were eased in spring 2020. The easing of the payment arrangements was based on a temporary legal amendment, under which the interest on late payment was in the end reduced from 7% to 2.5% for taxes within the scope of the payment arrangements and falling due between 1 March and 31 August 2020. Taxpayers could also apply for eased payment arrangements retroactively for value added taxes paid between January and March. Accrual data shows that the payment arrangements were used less extensively than anticipated in spring. In the fifth supplementary budget, the estimate of the 2020 tax revenue deferred to 2021 and 2022 was lowered to EUR 0.8 billion. Most of the applications for payment arrangements concerned value added taxes. The tax payment arrangements are recognised in the national accounts as general government revenue on an accrual basis for the year in which the payment obligation is created. For this reason, the measures are not shown in general government net lending recognised in the national accounts, but they will increase the borrowing requirement in the short term.

The guarantee authorisations of the State of Finland have been substantially increased during 2020. Increased preparedness for guarantee losses is the only sign of the increase in the Budget. So far, the increased guarantee authorisations have been used in a relatively limited scale. In spring, Finnvera's domestic financing authorisations were increased from EUR 4.2 billion to EUR 12 billion and as a result, the number of unused authorisations increased to about EUR 10 billion. A total of about one billion euros in new domestic guarantees had been granted by the end of August. The increase in authorisations will remain in effect until the end of 2025.

Table 2. Measures that will not directly impact general government net lending

	EUR bn
Guarantee and loan authorisations:	
Increasing Finnvera's domestic financing authorisations from EUR 4.2 to EUR 12 billion. About EUR 2 billion of the authorisations had been used in spring and thus the increase in the authorisations was about EUR 10 billion	10.0
Increasing Business Finland's lending authorisations, total increase for the period 2020-2022	0.3
State guarantees to cover Finnair's financing needs	0.5
State guarantees to shipping companies to ensure cargo traffic important to security of supply	0.6
State guarantees for the loans granted within the framework of the European instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE)	0.4
State guarantees for any losses arising from the Pan-European covid-19 guarantee fund to be established under the European Investment Bank	0.4
Capitalisations:	
injecting capital into Finnish Industry Investment for the setting up of a new stability programme	0.4
Equity investment in Finnish Minerals Group	0.5
Capitalisation arrangements in Finnair Plc and other state-owned companies	0.7
Easing of payment terms:	
Easing of payment terms for taxes due on or after 1 March 2020 and lowering the interest on late payments from 7% to 2.5%. The easing also applies to value added tax payments due in the period January - March. Assessing the impacts of the delays of 2020 tax revenue to 2021 and 2022.	0.8
Option of postponing pension contribution payments by three months	
Other support measures:	
Lowering of credit institutions' capital requirements	30.0
Bank of Finland's investments in commercial papers	1.0
Investments of the State Pension Fund in domestic commercial papers will be increased at to most of EUR 1 billion.	1.0
Easier TyEL reborrowing	
Authorising the Financial Stability Fund to borrow funds to meet its statutory obligations concerning the deposit guarantee	2.0

2.1.1 General government debt

Finland's general government debt is now rising rapidly as a result of the downturn triggered by the COVID-19 pandemic and the Government measures mitigating its impacts. The debt ratio will rise by more than ten percentage points this year, to 70%. In the years after that, the debt ratio will rise more slowly but it will reach 76% by the year 2024.

By the end of 2019, the debt ratio had been falling for four successive years and stood at 59.2% (EUR 142 billion). Most of the debt (about EUR 105 billion) was on-budget debt and central government debt totalled EUR 117.5 billion. Local government debt totalled EUR 23.5 billion or 9.8% of the GDP. Local government debt has increased in recent years whereas the central government debt-to-GDP ratio has decreased over the past four years. Central government debt will grow substantially during the outlook period, but local government is also becoming more indebted.

In addition to on-budget debt, a number of other items are also included in general government debt. For example, central government debt includes the debts of a number of off-budget units and companies as well as the collateral on the derivative contracts used in the management of the central government debt portfolio. Local government debt also includes the debt of many municipality-owned companies. The debt of the social security funds comprises the debts of the Employment Fund and the cash collateral on the derivatives of employment pension institutions.

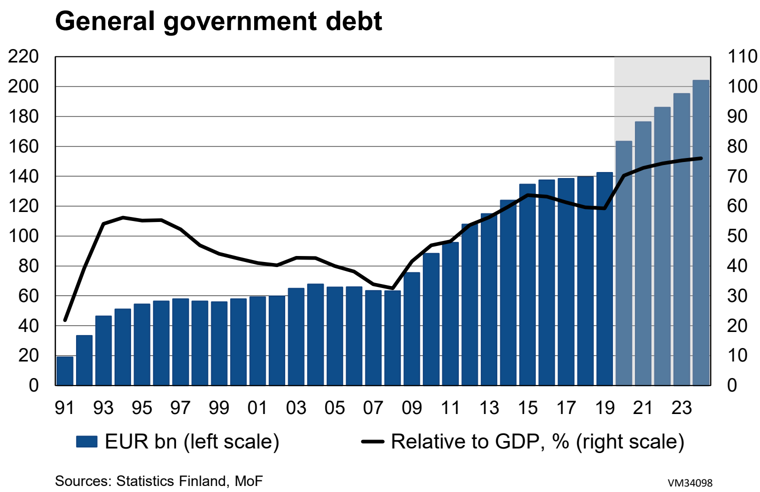
Changes in the debt ratio can be analysed using the table below. The substantial basic deficits accumulated by central and local government are a key factor affecting the debt ratio this year and in the coming years. This year, contraction of the GDP also increases the debt ratio whereas in the coming years, the debt ratio will again be reduced by economic growth.

Other factors describe the expenditure and revenue that do not impact the deficit recognised in the national accounts. The 2020 debt ratio is boosted by tax payment arrangements and providing companies with loans and capital, which do not increase the deficit recognised in the national accounts. In 2021, the debt-to-deficit ratio will be lowered by the expiry of the payment arrangements, while the allocation of the first funds for the fighter aircraft project will increase borrowing needs. Borrowing needs will be reduced by the Government plans to finance one-off spending increases with sales of shares between 2021 and 2022.

Table 17. Change in general government debt ratio and related factors

	2018	2019	2020**	2021**	2022**	2023**	2024**
Debt ratio, relative to GDP, %	59.6	59.2	70.2	72.8	74.3	75.3	76.0
Change in debt ratio	-1.6	-0.4	11.0	2.6	1.5	1.0	0.7
Factors impacting change in debt ratio							
Primary budgetary position (excluding employment pension funds)	1.0	1.3	7.2	4.8	3.8	3.0	2.7
Interest expenditure	0.9	0.8	0.7	0.6	0.6	0.5	0.5
Other factors[1]	-1.5	-0.8	1.1	-0.0	-0.5	-0.0	0.2
Change in GDP	-2.0	-1.7	2.0	-2.8	-2.4	-2.5	-2.6
Surplus of employment pension funds	1.0	1.1	0.1	0.4	0.5	0.5	0.4

1) Includes privatization proceeds, lending and factors related to the valuation and timing of revenue and expenditure.
Plus indicates increasing effect on debt ratio, minus a lowering effect on debt ratio.



2.2 Central government

For the first time in five years, there was no improvement in the central government budgetary position in 2019. The sharp contraction of the Finnish economy this spring has weakened central government finances as the automatic stabilisers have led to higher expenditure and lower revenue. Discretionary spending increases have also substantially weakened the central government budgetary position. The central government budgetary position is estimated to be EUR 16.8 billion in deficit this year, which is more than seven per cent of the GDP.

The active fiscal policy pursued by the Government has boosted discretionary spending. By mid-September 2020, the Government of Prime Minister Marin had presented five supplementary budgets to Parliament, which contain decisions on support for social security and companies and on economic stimulus measures. The supplementary budgets also contain decisions on new infrastructure projects and on support for local government finances.

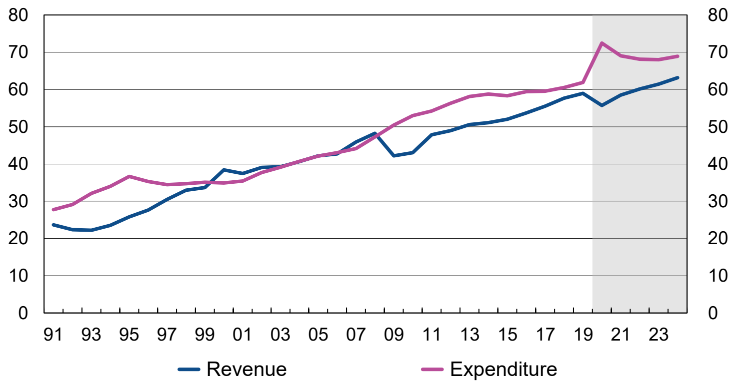
Central government expenditure will grow substantially this year and the spending will be more than EUR 10 billion higher than in 2019. The largest spending increases are allocated to subsidies paid to companies and current transfers to other general government sectors. Direct additional spending allocated to the purchasing of protective equipment and other supplies required to deal with the COVID-19 epidemic and additional inputs in education and training account for most of the increases in consumption expenditure. Capital expenditure is boosted by permanent increases in basic transport infrastructure management from 2020 onwards, as set out in the Government Programme, and the transport infrastructure projects contained in the supplementary budgets.

In addition to higher spending, the central government budgetary position will also be weakened by a fall in tax revenue, a result of the economic slowdown. There will be a substantial decrease in central government tax revenue this year compared with 2019 as the revenue from both direct and indirect taxes will fall.

Central government deficit will narrow substantially in 2021 when the one-off spending items for 2020 will be abolished and revenue will increase rapidly. Most of the subsidies and increases in consumption expenditure introduced this year only apply to the year 2020 but it is assumed that some of the decisions will also impact consumption in 2021. These include the purchases of protective equipment and pharmaceuticals required to deal with the COVID-19 pandemic.

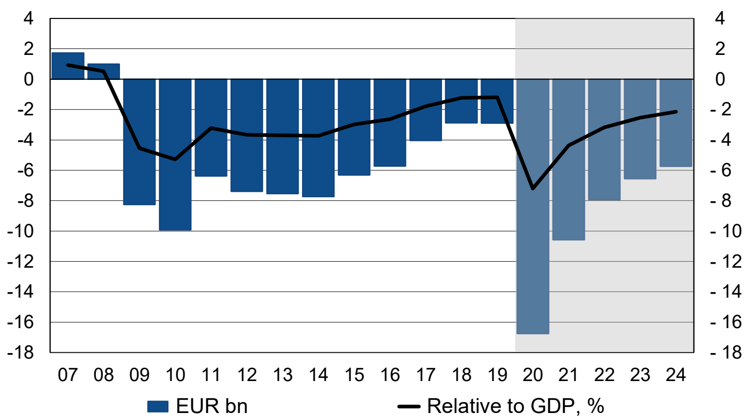
The deficit will shrink further in 2022. Despite a reduced deficit, the central government budgetary position will remain substantially weaker than in the period 2017-2019.

Central government revenue and expenditure
EUR bn



Sources: Statistics Finland, MoF VM34098

Central government financial balance



Sources: Statistics Finland, MoF VM34098

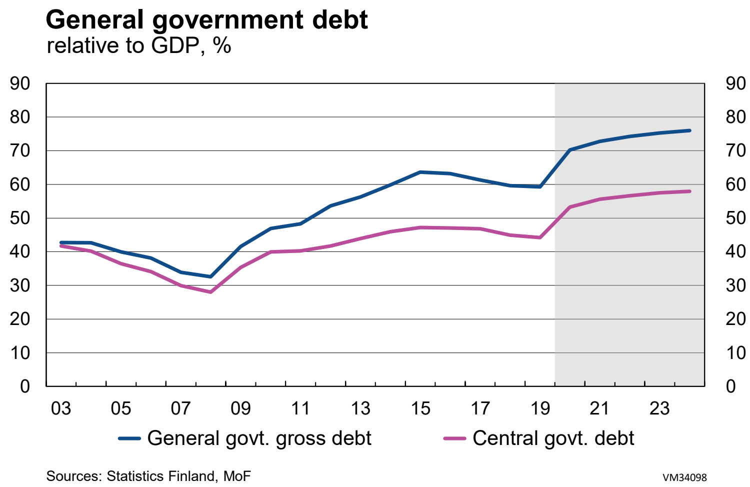


Table 18. Central government[1]

	2017	2018	2019	2020**	2021**	2022**
	EUR billion					
Current taxes	14.4	14.9	15.2	13.1	14.3	15.4
Taxes on production and imports	31.6	33.1	33.7	32.5	34.0	34.5
Social security contributions	0.0	0.0	0.0	0.0	0.0	0.0
Taxes and social security contributions, total[2]	46.9	48.7	49.7	46.4	49.2	50.8
Other revenue[3]	8.9	9.1	9.5	9.2	9.3	9.3
of which interest receipts	0.3	0.3	0.2	0.3	0.3	0.3
Total revenue	**55.8**	**57.8**	**59.1**	**55.6**	**58.4**	**60.1**
Consumption expenditure	13.7	14.0	14.6	16.2	16.3	16.1
Subsidies and current transfers, total	39.4	40.0	40.8	49.1	45.7	45.1
to general government	28.1	28.2	28.7	34.3	32.4	32.5
Interest expenses	2.1	1.9	1.8	1.6	1.4	1.3
Capital expenditure[4]	4.7	4.7	4.9	5.5	5.6	5.5
Total expenditure	**59.9**	**60.7**	**62.0**	**72.4**	**69.0**	**68.0**
Net lending (+) / net borrowing (-)	**-4.0**	**-2.9**	**-2.9**	**-16.8**	**-10.6**	**-7.9**
Primary balance[5]	-2.2	-1.2	-1.3	-15.5	-9.4	-6.9

1) As calculated in the National Accounts
2) Incl. capital taxes
3) Incl. capital transfers (excl. capital taxes) and consumption of fixed capital
4) Gross fixed capital formation and capital transfers
5) Net lending before net interest expenses

THE 2021 BUDGET AND CENTRAL GOVERNMENT SPENDING LIMITS

The Budget proposal for 2021 is based on the General Government Fiscal Plan of April 2020 and the Programme of Prime Minister Marin's Government. On-budget expenditure will total about EUR 64.2 billion in 2021. The expenditure will be about EUR 2.9 billion lower compared with the spending budgeted for 2020 (including the supplementary budgets 1-5). This has been prompted by the significant additional appropriations allocated in the 2020 supplementary budgets to managing the coronavirus situation and stimulating the economy. However, compared with the approved 2020 Budget, spending will be EUR 6.5 billion higher.

The COVID-19 pandemic has significantly changed Finland's economic situation from what was forecast at the start of the Government term, as total output will contract by 4.5% this year. Prompted by the state of emergency prevailing at the start of the crisis and the Emergency Powers Act taken into use, the Government temporarily abandoned the spending limits set at the start of the Government term. The spending limits will apply again in 2021 but some of the exceptions prompted by the coronavirus situation will remain in effect until the end of the year. The sudden deterioration of the economic situation has highlighted the role of the spending limits as an instrument curbing the growth of public expenditure and consolidating the central government budgetary position. The budget constraint introduced as part of the spending limits helps to channel resources with maximum effectiveness in relation to the goals set by the Government.

The spending limits for 2021 amount to EUR 52.0 billion, of which about EUR 107 million will be set aside as an unallocated reserve after the 2021 Budget proposal. Furthermore, a total of EUR 300 million has been set aside for supplementary budgets and EUR 372 million for future-oriented investments and other structural and cyclical policy measures. With the introduction of the exceptional situation mechanism set out in the Government Programme, the spending limits set in the 2021 Budget proposal will, on a temporary basis, be EUR 500 million higher than originally envisaged. In 2021, the Government will also set aside a reserve of EUR 500 million for one-off expenditure prompted by the coronavirus situation and urgent fiscal policy considerations.

The expenditure that varies according to the economic cycle and automatic fiscal stabilisers, such as unemployment security expenditure, pay security, housing allowances and basic social assistance, remain outside the spending limits. However, expenditure effects generated by changes in the criteria for these items are included within the spending limits. Debt interest payments, value added tax expenditure, financial investment expenditure and expenditure corresponding to technically transmitted payments by central government are also excluded from the spending limits. Because there has been no abatement of the coronavirus situation, temporary entry for 2021 will be consciously made in the spending limits rule: all COVID 19-related direct costs will be outside the spending limits during 2021. They include the expenditure arising from increases in testing and higher testing capacity, tracing, quarantines, treatment of patients, travel-related health security and vaccination. In addition, as a result of the coronavirus situation, expenditure resulting from higher budget authorisation for business funding was already treated as expenditure outside the spending limits in the spring 2020 General Government Fiscal Plan. Expenditure outside the spending limits will total about EUR 13.5 billion in 2021.

Compared with the approved 2020 Budget, spending in 2021 will be increased by such items as health security spending arising from the coronavirus situation (EUR 1.7 billion), purchase of the multirole fighters (EUR 1.5 billion), supplementary budget spending in 2020 impacting expenditure in 2021 (EUR 1.0 billion), index increases (EUR 0.4 billion), support for municipalities (EUR 0.3 billion) and the central government wage agreement (EUR 0.1 billion).

In 2021, on-budget revenue (excluding borrowing) is estimated to be about EUR 53.4 billion, with tax revenue accounting for about EUR 45.2 billion of the total. On-budget tax revenue will increase by about 8 % from what was budgeted for 2020 (including the supplementary budgets). Other on-budget revenue will increase by almost 9 %. Sales envisaged to finance the future-oriented investments impact the growth of other revenue, and these sales have been postponed to 2021 and 2022 because the situation in the market is now less favourable.

An index adjustment based on the index of wage and salary earnings will be made to the taxation of earned income. As set out in the Government Programme, the taxes on heating fuels, alcohol and tobacco products will increase in 2021. The Government is also taking measures to support industries by lowering the electricity tax class II to EU minimum and by extending the halving of the fairway dues by one year. In spring, the Government increased municipalities' share of corporate tax revenue by 10 percentage points. The increase was introduced to support local government finances and it was originally intended to expire the end of 2020. Under the Budget proposal, this temporary support scheme will remain in effect in 2021. The Government has also changed the corporate tax apportionment to compensate the lowering of the early childhood education fees to municipalities. The changes in the apportionment will reduce central government corporate tax revenue by EUR 0.6 billion in 2021. As a result of the changes in tax criteria (including changes in the corporate tax apportionment), the tax revenue will be almost one billion euros lower than what was estimated in the General Government Fiscal Plan presented in spring. Changes have also been made to the energy tax criteria by lowering the tax subsidy for paraffinic diesel in 2021 less than originally planned.

The macroeconomic outlook for this year and the year 2021 now looks better than what was envisaged in spring. Updating of the macroeconomic forecast and the accrual data will increase the tax revenue estimate for 2021 by EUR 0.2 billion compared with the forecast presented in the General Government Fiscal Plan. In spring 2020, the Government also decided to make it easier for companies to use the eased tax payment arrangements by lowering the penalty interest to 2.5 %. The payment arrangements have been used less extensively than anticipated and as a result, the tax revenue carried over to 2021 will be EUR 0.2 billion lower than what was assumed in the General Government Fiscal Plan.

The income of Veikkaus Oy will probably fall more than anticipated in spring, which will decrease non-tax revenue. The decrease in Veikkaus Oy income has been prompted by the lowering of its market share, a result of more competition in online gambling and the measures taken to reduce the negative impacts of gambling.

The 2021 Budget proposal is about EUR 10.8 billion in deficit, which will be covered with additional borrowing. Central government debt is estimated to total about EUR 135 billion at the end of 2021. The on-budget deficit has increased by about EUR 4.1 billion compared with the General Government Fiscal Plan presented in spring 2020. Because of the factors discussed above, the revenue forecast is EUR 0.9 billion lower than what was anticipated in spring. On-budget expenditure is about EUR 3.2 billion higher than what was set out in the spring 2020 General Government Fiscal Plan.

Table: Factors affecting changes in on-budget balance compared with the General Government Fiscal Plan of spring 2020, EUR billion.

	2021
Balance projection, General Government Fiscal Plan 2021-2024	**-6.7**
Revision of expenditure estimate	**-3.2**
Health security expenditure related to the coronavirus situation	-1.7
Impacts of the fourth supplementary budget of 2020	-0.5
Contributions to the European Union	-0.2
Estimated spending needs of the Ministry of Social Affairs and Health	0.2
Value-added tax expenditure of the Ministry of Defence administrative branch	0.2
Central government wage agreement	-0.1
Municipalities: compensations for tax criteria changes and central government transfers for basic services	-0.9
Change in other expenditure (net)	-0.1
Revision of revenue estimate	**-0.9**
New tax criteria changes (net)	-0.9
Tax payment arrangements (postponement of payments)	-0.2
Other factors affecting projected revenues (including accrual data and new economic forecast)	0.2
Changes to estimates of miscellaneous revenue and revenue from interest, dividends and sales of shares	0.1
Total change	**-4.1**
Balance projection, Budget proposal 2021	**-10.8**

Table 19. Forecasts for certain revenue and demand items impacting taxable income and the tax base

	2019	2020**	2021**	2022**	2024/2020**
	change, % per year				annual change, %
Taxable earned income and capital income	3.2	-0.2	2.4	2.6	2.0
Wage and salary earnings and other income	3.7	-2.0	2.9	2.5	1.7
Pensions and other social security benefits	1.8	8.3	0.1	2.4	3.2
Capital income	4.9	-10.5	5.8	3.2	1.0
Index of wage and salary earnings	2.1	1.7	2.5	2.0	2.2
Operating surplus	1.9	-8.4	7.4	5.6	3.2
Value of household taxable consumption expenditure	1.5	-3.5	5.4	2.7	3.6
VAT base	1.8	-2.3	6.1	2.5	3.6
Petrol consumption	-1.8	-5.9	0.2	-2.6	-2.5
Diesel consumption	-1.8	-0.5	-0.9	-0.7	-0.7
Electricity consumption	-4.1	-3.9	3.6	2.2	0.8
Duty-paid alcohol consumption	-1.8	-0.5	-0.9	-0.7	-0.7
New passenger cars	109000	97000	110000	113000	110200
Consumer price index	1.0	0.4	1.2	1.4	1.2

Table 20. Impact of change in selected tax base items on tax revenue

Tax category	Tax base	Change	Change in tax revenue, EUR million
Taxes on earned income	Wage and salary earnings	1-pp	428, of which central govt. 122 and local govt. 202
	Pension incomes	1-pp	143, of which central govt. 37 and local govt. 93
Capital income tax	Investment income	1-pp	37
Corporate tax	Operating surplus	1-pp	53, of which central govt. 36 and local govt. 17
VAT	Value of private consumption	1-pp	125
Car tax	Sales of new cars	thousands	5
Energy tax	Electricity consumption[1]	1-pp	9
	Petrol consumption	1-pp	13
	Diesel consumption	1-pp	15
Duty on alcoholic beverages	Alcohol consumption	1-pp	14
Duty on cigarettes	Cigarette consumption	1-pp	10

1 excl. manufacturing industries, datacenters and greenhouses

Table 21. Central government on-budget revenue

	2019	2020**	2021**	2022**	2023**	2024**	2024/2020**
	provisional financial ac-counts	budget incl. supple-mentary budget					annual change, %
	EUR billion						
Total tax revenue estimates	45.3	42.0	45.2	46.9	47.9	49.3	1.8
Income and wealth taxes	14.8	13.1	14.1	15.1	15.6	16.4	2.2
Taxes based on turnover	20.0	18.8	21.2	21.5	22.0	22.6	2.6
Excise duties	7.2	7.2	6.9	7.4	7.4	7.4	0.6
Other taxes	3.2	3.0	3.0	2.9	2.9	2.9	-1.7
Miscellaneous revenue	6.0	5.9	5.7	5.4	5.5	5.6	-1.6
Interest income and profit entered as income	1.8	1.5	2.4	2.4	1.7	1.7	3.0
Total revenue estimates	53.3	49.4	53.4	54.9	55.2	56.7	1.4

Table 22. Impact of discretionary tax measures on general government tax revenue

	2019	2020	2021**	2022**	2023**	2024**
	EUR million					
Earned income taxes	-216	-545	-414	-352	-378	-411
Average increase in municipal tax rate	40	0	0	0	0	0
Investment income tax	0	26	26	0	0	0
Corporate tax	9	-114	-113	-10	18	280
Other direct taxes	-126	2	-119	-13	2	0
Value-added tax	-16	-34	49	-9	0	0
Energy taxes	35	82	94	183	66	24
Other indirect taxes	113	43	93	59	50	33
Social security contributions	-141	-854	1577	20	65	-12

On-budget accounts and national accounts

No direct conclusions on the central government budgetary position recognised in the national accounts can be made on the basis of the on-budget budgetary position. On-budget entities showed a deficit of EUR 2.0 billion in 2019. According to the preliminary national accounts, central government deficit was EUR 2.9 billion or about EUR 0.9 billion higher.

The on-budget deficit will be higher than the budgetary position recognised in the national accounts in 2020 and 2021. The budget deficit will be increased by tax payment arrangements, which will postpone budgeted tax revenue to the year 2021 even though in the national accounts they are recognised as revenue for the current year. The budget deficit will also be widened by borrowing authorisations and capital injections, which are not recognised as expenditure in the national accounts.

The timing differences concerning such purchases as the fighter project of the Finnish Defence Forces will be one factor contributing to the gap between on-budget entities and the national accounts from 2021 onwards. Financing of the fighter project will increase the budget deficit, but it will only be recognised in the national accounts when the deliveries start. The 2021 budget deficit will be increased by changes in the payment timetables of a number of tax types and the end of the payment arrangements. However, these factors will not have any impact on the tax revenue recognised in the national accounts. Furthermore, the budget deficit in relation to the national accounts will be reduced by the planned sales of shares in 2021-2022.

It is not always possible to make conclusions about the central government borrowing requirement on the basis of the on-budget deficit. In 2019, central government borrowed an additional EUR 1.4 billion. Based on the deficit, the sum should have been EUR 2.0 billion, which means that the borrowing was about EUR 0.6 billion lower than what the budget deficit would have required. There are several reasons for this difference. Last year’s difference was primarily due to increases in state funds and the issue premiums arising from central government debt.

There are several reasons for the difference between the on-budget budgetary position and the central government budgetary position recognised in the national accounts. The most important of them is that in the national accounts, the central government sector is larger than on-budget entities, which basically comprise central government agencies. In the national accounts, the central government sector comprises on-budget entities, government funds (except for the State Pension Fund), universities and their real estate companies as well as the Senate Properties. The decisions on the categorisation of public sector units are regularly reviewed. All central government and general government units are listed on the website of Statistics Finland.

In addition to the classification, differences also arise because the criteria for recognising expenditure in the national accounts and in on-budget entities differ from each other. The national accounts are accrual-based whereas the on-budget entities are partially cash-based. Because of the differences in recognition criteria, deferrable appropriations in particular cause a difference between on-budget and national accounts expenditure. Deferrable appropriations are multi-year appropriations that are entered in the Budget for one year only. In the national accounts, deferrable appropriations are recognised on accrual basis in accordance with their year of use (as all other expenditure). There can be substantial variation in the net effect of deferrable appropriations from one year to another. In the national accounts, taxes, subsidies and EU contributions are converted into accrual-based items by means of timing adjustments. The difference arising from the timing adjustments can only be determined afterwards.

Such financial investments as loans granted and repaid by the state and sales and acquisitions of shares that in the national accounts are primarily treated as financial transactions are also included as revenue and expenditure in the on-budget budgetary position. Financial transactions do not have any effect on the central government budgetary position recognised in the national accounts. The financial transactions also include the derivatives, using which the State Treasury has achieved significant reductions in on-budget interest payments. The fact that derivative contracts reduce interest payments is not considered in the national accounts, which means that the interest expenditure recognised in the national accounts is substantially higher than the on-budget interest payments.

Table 23. On-budget balance and central government net lending[1]

	2018	2019	2020**	2021**	2022**
	EUR billion				
On-budget surplus (+) / deficit (-)[2]	**-0.4**	**-2.0**	**-17.5**	**-10.8**	**-7.0**
Privatization proceeds (net proceeds from equity sales)	-1.0	-0.1	1.5	-0.6	-0.8
Financial investment, net	-2.1	-0.4	-0.2	-0.4	-0.5
Revenue surplus in off-budget units	-0.3	-0.5	-0.5	-0.5	-0.5
Cash / accrual basis adjustment	0.5	0.1	0.4	1.9	1.5
Other adjustment items[3]	0.3	0.0	-0.5	-0.2	-0.6
Central government net lending (+) / borrowing (-)	**-2.9**	**-2.9**	**-16.8**	**-10.6**	**-7.9**

1) In National Accounts terms
2) Incl. government debt servicing
3) Incl. debt cancellations, profit on reinvested foreign direct investments, impact of the difference in the recording of deferrable budgetary appropriations, superdividends

EU Member States report to Eurostat twice a year on the differences between the figures in on-budget entities and the national accounts as part of their deficit and debt reporting. Detailed explanations should be given for the differences between the final accounts budgetary position for central government and other general government subsectors and national accounts net lending in the preceding years. Debt dynamics (the uniformity of the change in general government net lending and public debt) must also be detailed in the reporting.

2.3 Local government

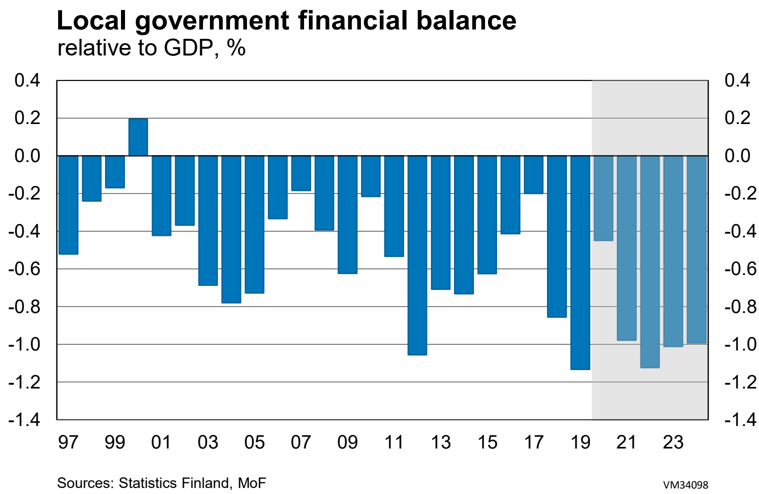
The local government budgetary position has weakened substantially in the past two years. However, the local government budgetary position is expected to improve this year compared with the exceptionally weak 2019. This will be achieved with support channelled to municipalities. Despite improvements, the local government budgetary position is expected to remain in deficit. In addition to the COVID-19 pandemic and combating it, local government expenditure will be increased by such items as the increase in health and social services expenditure caused by the ageing of the population, as well as by changes in tasks set out in Prime Minister Marin’s Government Programme and the measures to stimulate local government finances in conjunction with the crisis. The costs arising from the new tasks and additions to existing tasks are compensated to the municipalities through central government transfers.

The economic projection of local government finances for 2021-2024 is a pressure projection that, in addition to general economic and population trends, only takes into account the measures impacting local government finances that are already included in the Budget proposals and the General Government Fiscal Plan. The measures to support local government finances that are expected to be included in the autumn supplementary budget are also considered in the estimate. The figures are based on the minutes of the Government's budget session. The projection does not include municipalities' and joint municipal authorities' own measures for the period 2021-2024. They will only be included in the projection after the budgets have been finalised. Municipal tax rates have been kept at 2020 levels.

Despite the slow economic recovery, the local government deficit will widen in 2021 compared with the current year. This is mainly due to the collapse of local government revenue after the expiry of the temporary package to support local government finances. Consumption expenditure will be slower than in 2020 as the sales and payment revenue will recover from the dip caused by the COVID-19 crisis and the stimulus measures are coming to an end. However, it is estimated that the care and treatment queues in health and social services will be postponed from the current year to 2021 because non-urgent treatments have been put off as a result of the extensive coronavirus restrictions. COVID-19 testing expenditure is also expected to remain at high level. The Government has budgeted the cost arising from COVID-19 testing and protective equipment in government aid. It is not easy to adjust expenditure in an uncertain situation the duration of which is still difficult to predict and this makes the situation in local government even more problematic. For example, supporting public transport and cultural services may create additional expenditure pressures in local government finances for years to come. The pay rises agreed for the municipal sector in June 2020 will also boost the cost increases.

Local government investments are expected to remain at high level throughout the outlook period even though hospital construction will probably peak in the coming years. The investment pressures will, however, remain substantial because of the age of the building stock, infrastructure investment needs and migration. The bleak outlook for local government finances may, however, lead to postponement or cancellation of the final investment decisions, as more emphasis must be given to the prioritisation of investments.

The local government budgetary position will weaken in 2022 as the temporary support measures are coming to an end. The structural imbalance of local government revenue and expenditure is increasing the debts of the local government sector. Because of the budget deficits, local government debt-to-GDP ratio will continue to grow and will reach 13.0% in 2024.



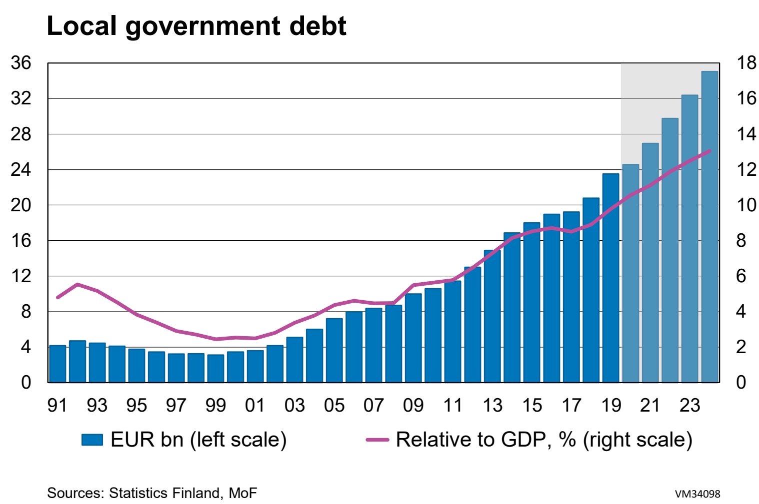


Table 24. Local government[1]

	2017	2018	2019	2020**	2021**	2022**
	EUR billion					
Taxes and social security contributions	22.8	22.5	23.2	23.8	24.6	24.7
of which municipal tax	19.1	18.8	19.4	19.9	20.1	20.7
corporate tax	1.9	1.9	1.9	2.0	2.6	2.1
real estate tax	1.8	1.8	1.9	1.9	2.0	2.0
Other revenue[2]	18.8	19.4	19.8	23.8	23.2	23.2
of which interest receipts	0.3	0.3	0.3	0.3	0.3	0.3
transfers from central government	13.9	14.2	14.4	18.0	17.2	17.1
Total revenue	**41.6**	**41.8**	**43.0**	**47.6**	**47.8**	**47.9**
Consumption expenditure	34.4	35.7	36.9	39.2	40.7	41.4
of which compensation of employees	21.0	21.4	21.8	22.6	23.2	23.7
Income transfers	2.7	2.6	2.8	2.9	2.9	3.0
of which social security benefits and allowances	0.7	0.7	0.8	0.8	0.8	0.8
subsidies and other transfers	1.9	1.8	1.9	2.1	2.0	2.0
interest expenses	0.1	0.1	0.1	0.1	0.1	0.1
Capital expenditure[3]	5.0	5.5	6.0	6.5	6.6	6.3
Total expenditure	**42.0**	**43.8**	**45.7**	**48.6**	**50.2**	**50.7**
Net lending (+) / net borrowing (-)	**-0.5**	**-2.0**	**-2.7**	**-1.0**	**-2.4**	**-2.8**
Primary balance[4]	-0.6	-2.2	-2.9	-1.2	-2.5	-2.9

1) As calculated in National Accounts
2) Incl. capital transfers and consumption of fixed capital
3) Gross capital formation and capital transfers
4) Net lending before net interest expenses

2.4 Social security funds

2.4.1 Employment pension institutions

Last year, the surplus of the employment pension institutions grew to 1.1% of the GDP. There was substantial growth in pension contributions and property income. The surplus of the sector will fall to almost zero this year. The decrease is mainly due to a sharp reduction in pension contributions, but property income is also expected to remain below last year's levels. The fall in pension contributions is due to a lower wage bill, a result of the downturn, and a temporary lowering of the private employers' pension contribution by 2.6 percentage points from May until the end of this year.

The surplus of the employment pension institutions will increase in 2021 and 2022 and will reach about 0.5% of the GDP. The surplus will be boosted by the expiry of the temporary lowering of the pension contributions and the growth of the wage bill. The increase that will take effect in 2022 will also improve the financial position of the sector. That year, private employers' pension contributions will be increased on a temporary basis to compensate for the reduction introduced this year.

Low interest rates are slowing down the growth in the property income of employment pension institutions. Property income will decrease this year and the growth will also be sluggish in the coming years. Pension assets totalled EUR 216 billion at the end of 2019. The value of the assets collapsed during the first months of the year and even though there was a partial recovery by the end of the second quarter, the value of the assets was still EUR 10 billion lower than at the start of 2020.

Table 25. Finances of social security funds[1]

	2017	2018	2019	2020**	2021**	2022**
	EUR billion					
Investment income	4.0	4.1	4.3	3.9	3.8	4.2
Social security contributions	27.3	27.9	28.5	27.2	29.6	30.3
of which contibutions paid by employers	17.6	17.6	17.9	16.5	18.3	18.9
contributions paid by insured	9.7	10.3	10.6	10.7	11.2	11.4
Transfer from general government	15.8	15.5	15.7	18.2	16.8	17.0
Other revenue	0.4	0.3	0.4	0.4	0.4	0.4
Total revenue	**47.5**	**47.8**	**48.9**	**49.6**	**50.6**	**51.9**
Consumption expenditure	3.5	3.7	3.8	3.9	4.1	4.2
Social security benefits and allowances	37.6	37.9	38.6	42.0	42.0	42.9
Other outlays	3.4	3.3	3.2	3.8	3.7	3.7
Total expenditure	**44.5**	**44.9**	**45.6**	**49.8**	**49.8**	**50.8**
Net lending (+) / net borrowing (-)	**3.0**	**2.9**	**3.3**	**-0.2**	**0.8**	**1.1**
Earnings-related pension schemes	2.4	2.3	2.7	0.3	0.9	1.2
Other social security funds	0.7	0.6	0.6	-0.5	-0.2	-0.1
Primary balance[2]	1.9	1.7	2.2	-1.1	-0.2	0.1

1) As calculated in National Accounts
2) Net lending before net interest expenses

2.4.2 Other social security funds

The other social security funds include the Social Insurance Institution of Finland, which is primarily responsible for basic security, and the Employment Fund, which is responsible for earnings-related unemployment security.

The other social security funds posted a surplus of 0.3% in 2019 but in 2020, they will be in deficit. The downturn will increase unemployment expenditure and the expenditure arising from other social security benefits. The financial position is also weakened by the 0.5 percentage-point reduction in the unemployment insurance contribution from the start of the year. The expenditure is also increased by a number of Government decisions expanding and improving social security, such as increases in basic pensions and decisions on temporary improvements in unemployment benefits.

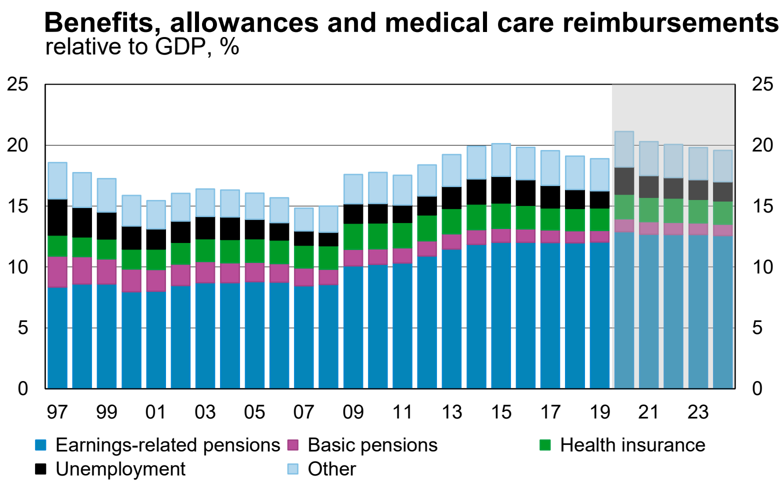
The sharp increase in temporary layoffs during the first half of the year has been the main factor increasing unemployment expenditure. The situation of the Employment Fund is eased by the fact that until the end of this year, the Government is paying part of the earnings-related benefits provided for temporary layoff periods.

In 2021, the financial position of the sector will be boosted by the 0.32 percentage-point increase in the unemployment insurance contribution. Decrease in temporary layoffs will also push down unemployment expenditure even though unemployment as a whole will remain high. In the coming years, the financial position will remain slightly in deficit but close to balance.

Table 26. Social security contributions rates and pension indices

	2017	2018	2019	2020	2021**	2022**
Social insurance contributions[1]						
Employers						
Sickness insurance	1.08	0.86	0.77	1.34	1.53	1.40
Unemployment insurance	2.41	1.91	1.50	1.26	1.43	1.43
Earnings-related pension insurance	17.95	17.75	17.35	15.22	16.95	17.38
Local government pension insurance	21.95	21.60	21.17	20.77	20.77	20.77
Employees						
Sickness insurance	1.58	1.53	1.54	1.86	2.01	1.87
Unemployment insurance	1.60	1.90	1.50	1.25	1.40	1.40
Earnings-related pension insurance	6.45	6.65	7.05	7.45	7.45	7.45
Benefit recipients						
Sickness insurance	1.45	1.53	1.61	1.65	1.62	1.60
Pension indices						
Earnings-related index (over 65)	2534	2548	2585	2617	2637	2673
National pension index	1617	1617	1617	1633	1641	1659

1) Annual averages. The contributions of employers and the unemployment and employment pension contributions of beneficiaries as percentages of wages and salaries. The figures are weighted averages.



Sources: Statistics Finland, MoF

2.5 Long-term sustainability of public finances

Ageing of the population has already increased pension expenditure over the past ten years and it is creating major pressures on the long-term sustainability of Finland's general government finances. An increase in the ageing population is the main factor boosting the health and long-term care expenditure in the coming decades, and the current total tax rate will be inadequate to finance these increases in the future. At the same time, the working-age population, which pays the taxes needed to finance the public services and social security, is shrinking.

There is a long-term imbalance (sustainability gap) between general government revenue and expenditure. The focus in the sustainability gap calculations is on estimating how the ageing of the population is affecting the outlook for general government finances in the coming decades. In addition to the ageing of the population, there are also many other pressures on general government finances, which arise from such issues as climate change and the need to renew and repair public infrastructure.

The sustainability gap calculation shows how much general government finances should be consolidated in the near future in order to ensure that the finances are in balance in the long-term. In other words, after the adjustment, there would no longer be any need to increase the tax rate, cut spending, introduce structural reforms consolidating general government finances or increase general government debt. However, the sustainability gap calculation does not tell how the general government debt ratio should be stabilised or set the timetable for this process. Furthermore, the potential impacts of the adjustment or structural reforms on economic growth are not taken into account.[1]

1 As the sustainability gap (S2 indicator) does not take into account the potential adverse effects of direct adjustment measures on economic growth, it should not be used as the sole instrument to assess the required adjustment. There are other methods in which more consideration is given to the negative growth impacts of direct adjustment measures. Technically, the results given by the S2 indicator correspond to a situation in which the fiscal multiplier would be zero (the adjustment measures do not slow down economic growth). It is generally assumed that direct adjustment measures will cut economic growth. At the same time, however, many of the structural reforms do not have such adverse effects and they can also strengthen the basis for economic growth.

The Ministry of Finance estimates that the sustainability gap is about 3.5% relative to the GDP or almost EUR 10 billion at the 2024 level. The medium-term estimate of public finances has led to a slight narrowing of the estimated sustainability gap compared with the figures published in early July. Compared with the autumn 2019 estimate, new data has narrowed the sustainability gap by more than one percentage point. These changes are described in more detail in the box below and in the report Sustainability of Finland's public finances (in Finnish, with an English abstract) published by the Ministry of Finance in July.[2]

Despite the changes, the sustainability gap estimate has, in qualitative terms, remained more or less unchanged: ageing of the population presents a major challenge to the sustainability of Finland's general government finances. It is also estimated that the general government debt-to-GDP ratio will reach 75% in the next few years, which will mean more risks for general government finances than the earlier debt ratio of about 60 per cent.

In the sustainability gap calculation, general government debt is not expected to settle at any specific level. Thus, the debt balance produced by the calculation may also be relatively high or low, depending on the level of the debt ratio at the time of the calculation and the estimated impact of the ageing of the population on public spending trends in the coming decades. For this reason, the debt sustainability of general government finances should also be examined in other ways.

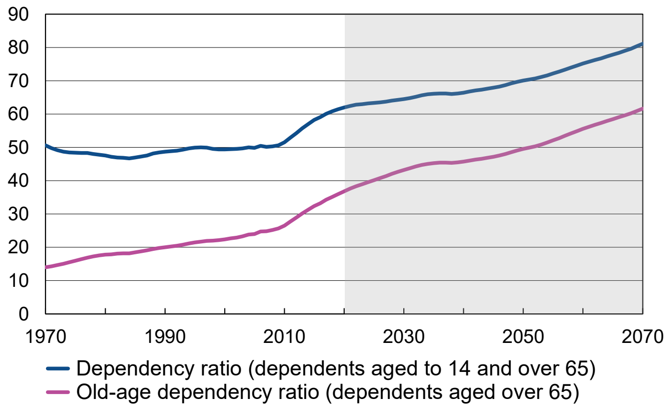
The sustainability gap calculation is a pressure projection and not the most probable future scenario. The calculation is based on the assumption of unchanged policy, which means that it projects trends under current legislation and practices to the future with the help of population projections, spending decompositions by age groups, and estimates of long-term economic growth trends. The Ministry of Finance's estimate of the long-term sustainability of general government finances is based on the methods and calculation principles jointly agreed in the EU. Only the decisions whose impacts on general government finances can be estimated with sufficient accuracy are considered in the sustainability gap estimate. More detailed

2 https://julkaisut.valtioneuvosto.fi/handle/10024/162357

computing procedures are set out in the methodology description of the Ministry's sustainability gap calculations.[3]

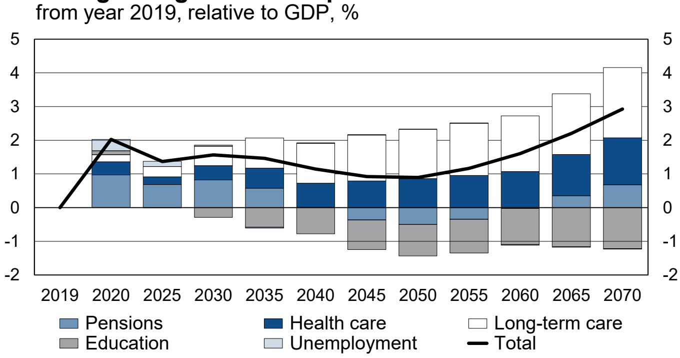
The aim is to use realistic assumptions as a basis for the sustainability gap estimate. As any indicator, the estimate changes slightly as the data and forecasts used are updated. The table below presents key assumptions used in the sustainability gap calculation and examines the sensitivity of the calculation to changes in the assumptions. In fact, the sustainability gap calculation and its sensitivity assessments provide a useful and logical way to analyse the size of the challenge arising from the ageing of the population and how this challenge can be addressed.

Dependency ratio and old-age dependency ratio
dependents per 100 persons of working age



Source: Statistics Finland (Population projection 2019)

Change in age-related expenditure
from year 2019, relative to GDP, %



The figure is compiled using the model developed by the Ministry of Social Affairs and Health for social expenditure analysis

Source: MoF

VM34098

3 https://vm.fi/en/descriptions-of-methods

Table 27. Impact of various factors on the sustainability gap

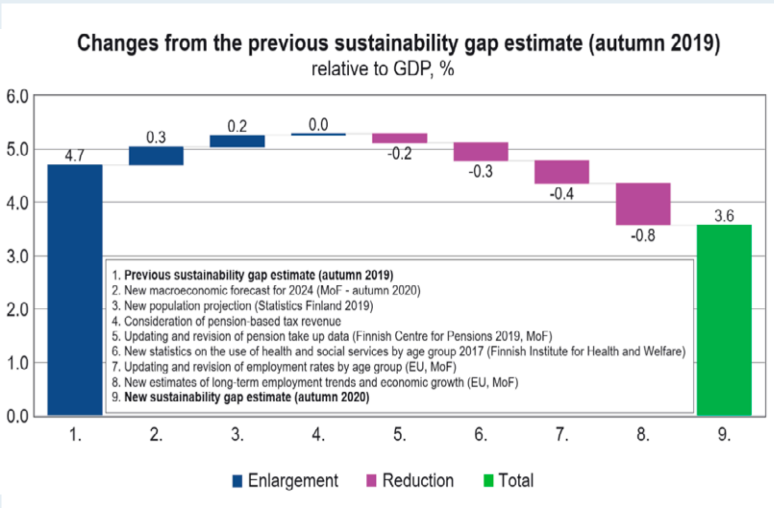
<table>
<tr><th></th><th>Baseline scenario (autumn 2020)</th><th>Change</th><th>Impact on sustainability gap, pp.[1]</th></tr>
<tr><td>Growth in general productivity (and real earnings) in 2025-2070</td><td>on average 1.5%</td><td>+0.5 pp.</td><td>-0.3</td></tr>
<tr><td>Employment rate (15-64 yrs) in 2025-2070</td><td>71.9% in 2024 and 75.9% in 2070</td><td>+1.0 pp.</td><td>-0.3</td></tr>
<tr><td>Annual productivity growth of public health and social services in 2025-2070</td><td>0%</td><td>+0.5 pp.</td><td>-1.9</td></tr>
<tr><td>General government structural primary balance[2] / GDP in 2024</td><td>-2.2%</td><td>+1.0 pp.</td><td>-1.0</td></tr>
<tr><td>Total fertility rate</td><td>1.35</td><td>+0.35 (= 1.70)</td><td>-0.2</td></tr>
<tr><td>Annual net immigration (impact if employment rate remains unchanged)</td><td>15,000</td><td>+7,500 (= 22,500)</td><td>-0.4</td></tr>
<tr><td>Life expectancy at the age of 50 (33.6 years in 2019)</td><td>Will be increased by 7 years by 2070</td><td>-1.4 years (= 5.6 years)</td><td>-0.5</td></tr>
<tr><td rowspan="2">Postponement of the need for health and social services as life expectancy increases</td><td rowspan="2">Will be postponed by half of the life expectancy increase (people aged over 50)</td><td>Will be postponed at the rate of life expectancy increase</td><td>-1.1</td></tr>
<tr><td>No postponement as life expectancy increases</td><td>1.1</td></tr>
<tr><td>Inflation (change in GDP deflator and consumer prices) in 2025-2070</td><td>2%</td><td>-0.5 pp.</td><td>approx. 0.0</td></tr>
<tr><td>Real interest rate on central and local government debt (+ impact on the discount rates of the two sectors)</td><td rowspan="3">Real interest rate on central and local government debt and interest income 2%, real rate of return on central and local government's investments in shares 4% and real rate of return on employment pension schemes' investments 3.5% (from 2040s onwards)</td><td>-0.5 pp.</td><td>-0.2</td></tr>
<tr><td>Real interest rate on central and local government debt and impact on the real rate of return on central and local government and employment pension schemes' investments in bonds (+ impact on all sectors' discount rates)</td><td>-0.5 pp.</td><td>approx. 0.0</td></tr>
<tr><td>Real interest rate on central and local government debt and real rate of return on all general government investments (+ impact on all sectors' discount rates)</td><td>-0.5 pp.</td><td>0.6</td></tr>
</table>

[1] The calculations are based on summer 2020 MoF sustainability gap calculations (impact of assumption changes are stable over different calculation rounds)

[2] Deficit excl. interest payments

NEW DATA HAS NARROWED THE SUSTAINABILITY GAP ESTIMATE DURING THE PAST 12 MONTHS

The method for calculating the sustainability gap estimate has been revised and the data used as a basis has been updated after the estimate published in September 2019. The changes impacting the sustainability gap estimate are illustrated in the chart below. These changes were already incorporated in the sustainability gap estimate presented in the Ministry of Finance's report Sustainability of Finland's public finances, which was published in early July.



Even though the current downturn caused by the COVID-19 pandemic has significantly weakened the estimate of Finland's general government finances in 2024 (the calculation base year), it is assumed that this change will only increase the sustainability gap by 0.3 percentage points compared with the autumn 2019 estimate. However, as the crisis is not yet over, the total impacts of the pandemic are not yet known. The impacts may be greater than estimated as the assumption still is that the pandemic will not have any impacts on long-term employment trends and economic growth. If the pandemic continues, it will probably also weaken long-term employment trends and economic growth, which will widen the sustainability gap.

Second: the latest population projection published by Statistics Finland in November 2019 has been taken into account in the sustainability gap estimate. A total fertility rate that is lower than previously estimated would slightly widen the sustainability gap.

Third: in accordance with EU calculations, the impact of the taxes collected from pension income has been taken into account in the calculations. The impact of this change is close to zero and for this reason it has not been taken into account in the previous sustainability gap estimates produced by the Ministry of Finance.

Fourth: the system of calculating pension expenditure has been made more accurate by updating the way in which the start dates of different pension types will develop in the coming decades. The assumptions on pension take up trends used in the long-term calculations published by the Finnish Centre for Pensions in 2019 have been used as a basis. These changes have slightly lowered the sustainability gap estimate.

Fifth: information on the use of health and social services by age group and gender have been updated on the basis of the latest data provided by the Finnish Institute for Health and Welfare. The previous figures were from the year 2011 and the new data is from the year 2017. At the same time, the data service classification has been changed and the figures can now be updated more frequently. Based on the new information, it is estimated that the need for health and social services will increase more slowly than in the past, which will slightly narrow the sustainability gap.

Sixth: the estimate of the employment rates of each age group has been updated and revised on the basis of recent statistics. The updating of these employment rates is now more closely based on the work described in chapter 5.1 of the report Sustainability of Finland's public finances. The impact described in this item is mainly based on changes in the employment rates of individuals aged over 65 and the impact on the total employment rate in the age group 15-64 is described in the next item. The employment rate assumption for the individuals aged over 65 is, however, relevant in the coming decades as the retirement age will rise. These changes will narrow the sustainability gap by almost 0.5 percentage points.

Seventh: the estimate of the long-term employment trends and economic growth has been updated. The updates to the employment rate in the age group 15-64 used in the calculations are described in more detail in chapter 5.1 of the report Sustainability of Finland's public finances. A new and a slightly higher estimate of labour productivity trends in the next two decades is now also used.

All these changes have narrowed the sustainability gap by 1.1 percentage points compared with the estimate produced in autumn 2019.

LONG-TERM GENERAL GOVERNMENT DEBT SCENARIOS

Finland's general government debt will reach new levels as a result of the COVID-19 pandemic and the economic downturn that followed it. Before the financial crisis (in 2008), general government debt-to-GDP ratio was below 33% and at the start of the coronavirus pandemic it stood at about 60%. According to the latest Ministry of Finance forecast, the debt ratio is expected to reach 75% by the year 2024. This box examines changes in the debt ratio on a longer perspective (until 2040) in three different scenarios: in a pressure calculation based on the baseline scenario and in two scenarios in which general government finances are consolidated during the 2020s.

The debt ratio will grow throughout the 2020s because the Finnish population is ageing. The long-term economic outlook is also subdued. It is estimated that annual economic growth will average 1.5% between 2025 and 2040.

The box examines the trends in general government debt on the basis of the deficit-debt-dynamic equation. When calculations are made at the level of general government finances, it should also be taken into account that the surpluses accumulated by employment pension institutions cannot be used to repay the debts. Central and local government debt can be defined as follows:

$$DEBT_t = DEBT_{t-1} + i_t DEBT_{t-1} - PB_t,$$

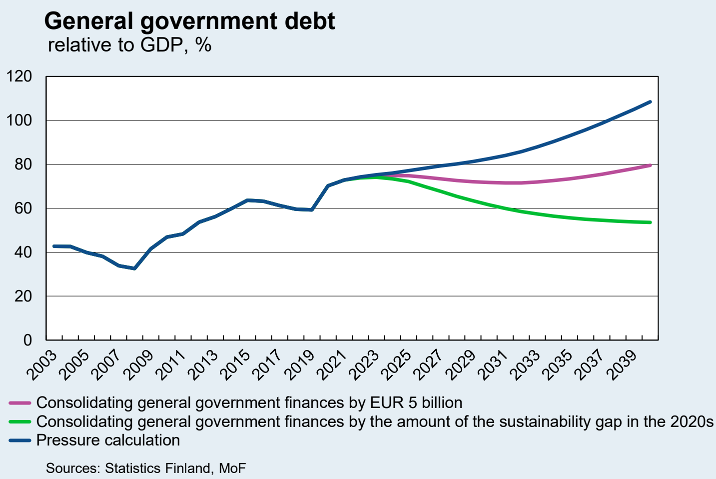
in which t is time, DEBT is debt, i is the interest on the debt and PB is the basic budgetary position (budgetary position excluding interest payments). Debt in year t is determined on the basis of the previous year's debt, debt interest expenditure and the basic budgetary position. In long-term debt calculations, the basic budgetary position is also weakened by the growth in age-related expenditure due to the ageing of the population.

In a pressure calculation based on the baseline scenario, general government debt ratio will exceed 100% by the year 2040. Low interest rates will slow down debt ratio growth in the next few years. However, the debt ratio will continue to grow because the combined basic deficit of central and local government is substantial. In the longer term, a gradual rise in interest rates is expected. The implicit interest on general government debt (interest expenditure in relation to debt) is estimated to be about 2% at the end of the 2020s and 4% at the start of the 2040s. Longer-term interest rate assumptions are based on the interest rate assumptions agreed in the EU. The implicit interest on general government debt now stands at 1%.

The calculation presented in Scenario 1 shows how the debt ratio would change if general government finances are consolidated by EUR 5 billion by the year 2026.
If the consolidation of general government finances is started during the current parliamentary term, a consolidation of about EUR 5 billion would be enough to briefly stabilise the debt ratio at the end of 2020s. However, the debt ratio would start growing again in the 2030s.

Scenario 2 presents a calculation in which general government finances are consolidated by almost EUR 10 billion (which is roughly the size of the estimated sustainability gap) in the 2020s. In this scenario, the debt ratio will return to the pre-downturn levels (about 60%) by the end of the 2020s. This means that in about ten years from now, the debt ratio would settle at the 60% benchmark agreed in the EU. In the long term, the debt ratio would stabilise at about 50 per cent.

Chart 1. Changes in general government debt ratio in different scenarios



Changes in the debt ratio largely depend on how Finland decides to consolidate its general government finances. The sooner the measures consolidating general government finances start having an impact, the easier it is to put the debt ratio on a downward trend. The assumption in the above scenarios is that the consolidation of general government finances between 2022 and 2026 will be slightly back- loaded. The nature of the measures also matters: if they are in the form of structural reforms strengthening the growth potential of the economy that do not generate any costs for public finances, the scale of the measures required will be smaller than if the consolidation is by means of direct adjustment. This is because spending cuts and tax increases slow down economic growth whereas structural reforms have the opposite effect.

Supplementary statistics

1. Evolution of forecasts over time
2. Outturn data and forecasts used in budget process for 2015–2019
3. National balance of supply and demand
4. Financial balance of the Finnish economy

Table 1. Evolution of forecasts over time[1]

	2019				2020**				2021**				2022**			
Forecast date	summer19	autumn19	winter19	outcome	winter19	spring20	summer20	autumn20	winter19	spring20	summer20	autumn20	winter19	spring20	summer20	autumn20
GDP at market prices, change in volume, %	1.6	1.5	1.6	1.1	1.0	-5.5	-6.0	-4.5	1.1	1.3	2.5	2.6	1.2	1.3	1.7	1.7
Consumption, change in volume, %	1.3	1.6	1.5	1.0	1.6	-1.3	-0.7	-1.5	1.2	1.3	1.8	3.1	1.2	1.2	0.9	0.8
Exports, change in volume, %	2.9	2.4	4.0	7.5	1.9	-6.2	-14.0	-12.5	1.9	3.2	5.5	5.3	2.0	2.1	3.8	3.8
Unemployment rate, %	6.6	6.5	6.7	6.7	6.5	8.0	8.5	8.0	6.4	8.1	9.0	8.2	6.4	7.9	8.8	8.0
Consumer price index, change, %	1.2	1.1	1.1	1.0	1.3	0.7	0.3	0.4	1.6	1.3	1.1	1.2	1.6	1.5	1.4	1.4
Central government net lending, relative to GDP, %	-0.7	-0.9	-0.9	-1.2	-1.4	-5.5	-7.3	-7.2	-1.2	-2.7	-3.4	-4.4	-1.0	-3.0	-2.8	-3.2
General government net lending, relative to GDP, %	-0.6	-1.0	-1.0	-1.0	-1.4	-7.2	-8.2	-7.7	-1.4	-4.0	-5.1	-5.0	-1.3	-4.1	-4.0	-3.9
Central government debt, relative to GDP, %	44.2	44.4	43.9	44.2	43.6	51.9	54.8	53.3	44.0	53.2	55.8	55.6	44.3	54.5	56.9	56.6

[1] Economic Survey
Sources: Statistics Finland, MoF

Table 2. Outturn data and forecasts used in budget process for 2015–2019

	Years 2015-2019		Average forecast accuracy	
	Forecast averages, % ch.	Outcome averages, % ch.	Forecast under-/over-estimation[1], pp.	Magnitude of forecast accuracy[2], pp.
GDP (volume)	1.4	1.5	-0.1	1.0
GDP (value)	2.9	3.0	-0.1	0.8
Private consumption (value)	2.3	2.4	-0.1	0.7
Current account, relative to GDP, %	-0.4	-0.5	0.1	0.7
Inflation	1.4	0.6	0.8	0.8
Wage bill	2.0	2.4	-0.4	0.9
Unemployment rate	8.3	8.2	0.1	0.6
Central government debt, relative to GDP, %	48.9	46.4	2.5	2.5
Central government net lending, relative to GDP, %	-2.2	-2.0	-0.2	0.6
General government net lending, relative to GDP, %	-1.8	-1.4	-0.4	1.1

Forecasts are compared with March/July preliminary national accounts data.
Averages for the past five years are calculated on the basis of spring and autumn forecasts concerning the budget year.

1 Over- or understimation is indicated by average forecast error.

2 The average of absolute error values indicates the average magnitude of forecast errors, regardless of the direction of error.

Table 3. National balance of supply and demand, EUR million

	Current prices					
	2017	2018	2019	2020**	2021**	2022**
GDP at market prices	225 933	233 664	240 556	232 563	242 197	250 365
Imports of goods and services	84 871	92 513	95 128	81 407	85 816	89 679
Total supply	**310 804**	**326 177**	**335 684**	**313 902**	**328 030**	**340 049**
Exports of goods and services	84 975	90 006	96 488	80 661	86 053	90 649
Consumption	171 879	177 158	181 442	181 000	189 176	193 688
private	120 301	123 765	126 053	121 674	128 071	131 968
public	51 578	53 393	55 389	59 326	61 105	61 720
Investment	52 852	56 358	57 487	55 661	56 583	59 259
private	43 638	46 495	47 247	44 400	45 225	48 018
public	9 214	9 863	10 240	11 261	11 358	11 241
Total demand	**311 196**	**326 328**	**336 094**	**314 312**	**328 440**	**340 459**
	At reference year 2010 prices; not additive					
	2017	2018	2019	2020**	2021**	2022**
GDP at market prices	200 417	203 448	205 777	196 573	201 697	205 036
Imports of goods and services	83 430	87 986	90 137	81 119	84 327	86 699
Total supply	**275 117**	**282 255**	**286 529**	**269 181**	**277 166**	**282 599**
Exports of goods and services	82 535	83 928	90 221	78 945	83 160	86 303
Consumption	153 812	156 459	157 994	155 672	160 422	161 639
private	107 608	109 511	110 466	106 223	110 470	112 190
public	46 207	46 953	47 533	49 399	49 946	49 414
Investment	46 688	48 526	48 050	45 787	45 774	47 080
private	38 513	39 946	39 357	36 360	36 432	37 966
public	8 173	8 579	8 694	9 450	9 363	9 124
Total demand	**284 132**	**291 292**	**296 657**	**279 434**	**288 433**	**294 793**

Table 4. Financial balance of the Finnish economy

	2015	2016	2017	2018	2019
	relative to GDP, %				
Gross investment	**21.2**	**22.7**	**23.4**	**24.1**	**23.9**
households and non-profit institutions	6.1	6.7	7.0	7.2	7.2
non-financial corporations and financial and insurance corporations	11.3	11.9	12.3	12.7	12.4
general government	3.7	4.1	4.1	4.2	4.3
Gross saving[1]	**21.0**	**21.3**	**23.2**	**23.6**	**24.2**
households and non-profit institutions	3.9	3.5	3.6	4.0	4.7
non-financial corporations and financial and insurance corporations	15.9	15.5	16.2	16.3	16.2
general government	1.1	2.3	3.3	3.3	3.3
Financial surplus	**-0.7**	**-1.9**	**-0.7**	**-1.7**	**-0.1**
households and non-profit institutions	-2.5	-3.6	-3.5	-3.3	-2.6
non-financial corporations and financial and insurance corporations	4.1	3.3	3.3	2.5	3.6
general government	-2.4	-1.7	-0.7	-0.9	-1.0
Statistical discrepancy	0.0	0.0	-0.2	-0.1	0.1

[1] Incl. capital transfers (net)

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